AR80

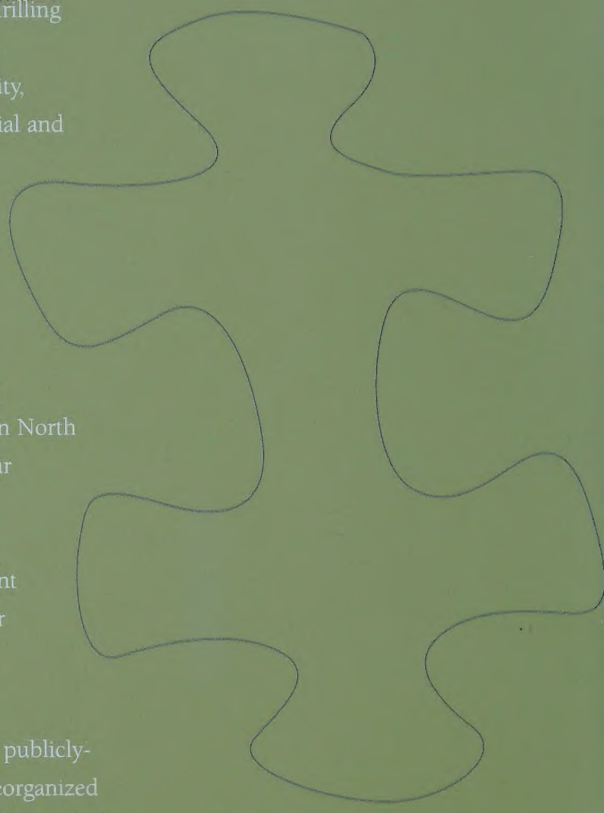
PHOENIX
TECHNOLOGY INCOME FUND

Linking People, Technology and Opportunity

2005 ANNUAL REPORT

Profile

Our vision is to be the first-choice provider of innovative drilling technologies and services for oil and natural gas producers in Canada and the United States. Our core values of integrity, teamwork, passion for excellence, customer focus, and social and environmental responsibility guide our actions. Our performance values of efficiency, accountability and strong corporate governance translate into our operational and financial results.



Advanced Drilling Technologies

Phoenix is a progressive directional and horizontal drilling services company, which is among the largest contractors in North America, having drilled over 6,000 wells. In addition to our drilling services, Phoenix engineers, manufactures and operates proprietary drilling guidance systems, all backed by our innovative and specialized research and development group. Phoenix combines experienced personnel, customer focus, and industry-leading technology to deliver superior project results.

Phoenix has operated in Canada since 1985 and became a publicly-traded company on March 24, 2003. The Company was reorganized to an income fund on July 1, 2004. Phoenix trades under the symbol PHX.UN on the Toronto Stock Exchange (TSX).

Annual General Meeting

The ANNUAL GENERAL MEETING of Phoenix Technology Income Fund will be held on May 10th, 2006 from 3:00 pm to 4:00 pm at the Bankers Hall Auditorium, Lower Level, 315 - 8th Avenue S.W., Calgary, Alberta.

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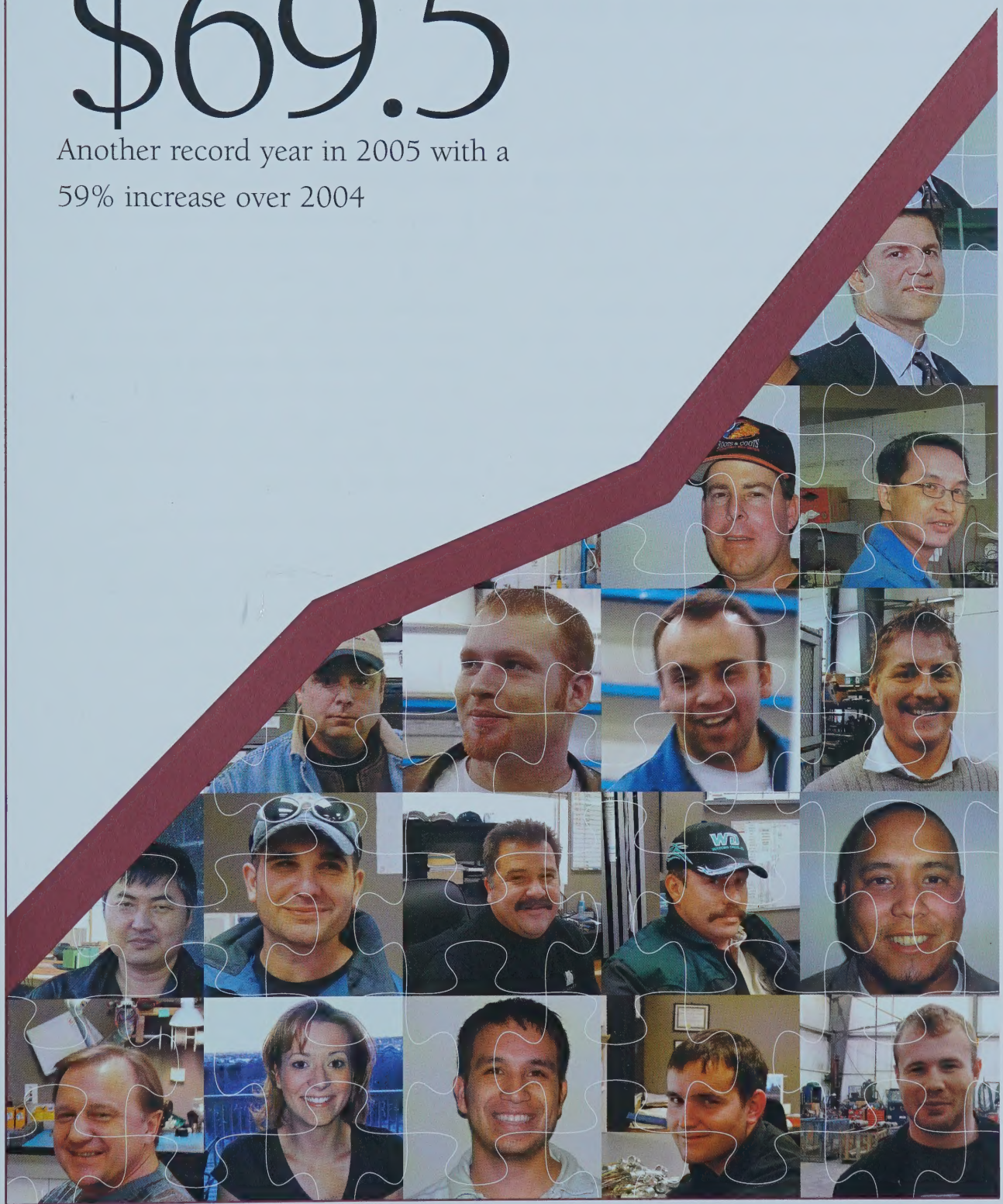
IBC Corporate Information

Revenue ($ millions)

$69.5

Another record year in 2005 with a 59% increase over 2004



Year End 2002	Year End 2003	Year End 2004	Year End 2005
$15.1	$35.3	$43.8	$69.5

Understanding Our Business

Horizontal and Directional Drilling

Directional drilling is performed on any well that is intentionally steered at an angle away from a vertical plane. This type of drilling can be broken down into two specific types, horizontal and directional.

A directional well is generally referred to as any well that is planned, such that the target, or bottom hole objective, is not directly under the surface location and requires some method of well steering to guide the well bore to that target. Directional wells are typically used to drill to some target that is not accessible with a vertical well. For instance, a zone of hydrocarbon bearing rock might lie directly below a river, lake, city, or some other area that is inaccessible to a drilling rig. In this case, a plan is made to steer the well bore in the appropriate direction as it is being drilled. In order to do that, precise measurements of the location and condition at the end of the well bore are needed. With these measurements a bent housing mud motor is oriented in the direction that a new well bore will be drilled. Using this technique well bores can be steered from vertical up to ninety degrees and higher.

A well is considered to be horizontal if the inclination is planned for anything above eighty degrees from vertical. Horizontal wells are designed to maximize production rates and reserve drainage by drilling lengthwise through a target zone. This increases the exposure to hydrocarbon bearing rock formation and will increase the production rates compared to drilling a vertical well through the same target.

Mud Pulse vs. Electro-Magnetic Telemetry

In order to steer a directional well, a directional driller must first have an accurate measurement of where the well is currently being drilled. This is accomplished by transmitting measurements from near the bottom of the well bore to operators on surface. These measurements include the inclination (measured from vertical) and the direction (measured from magnetic North) of the well bore, as well as other characteristics of the rock formation that is being drilled through.

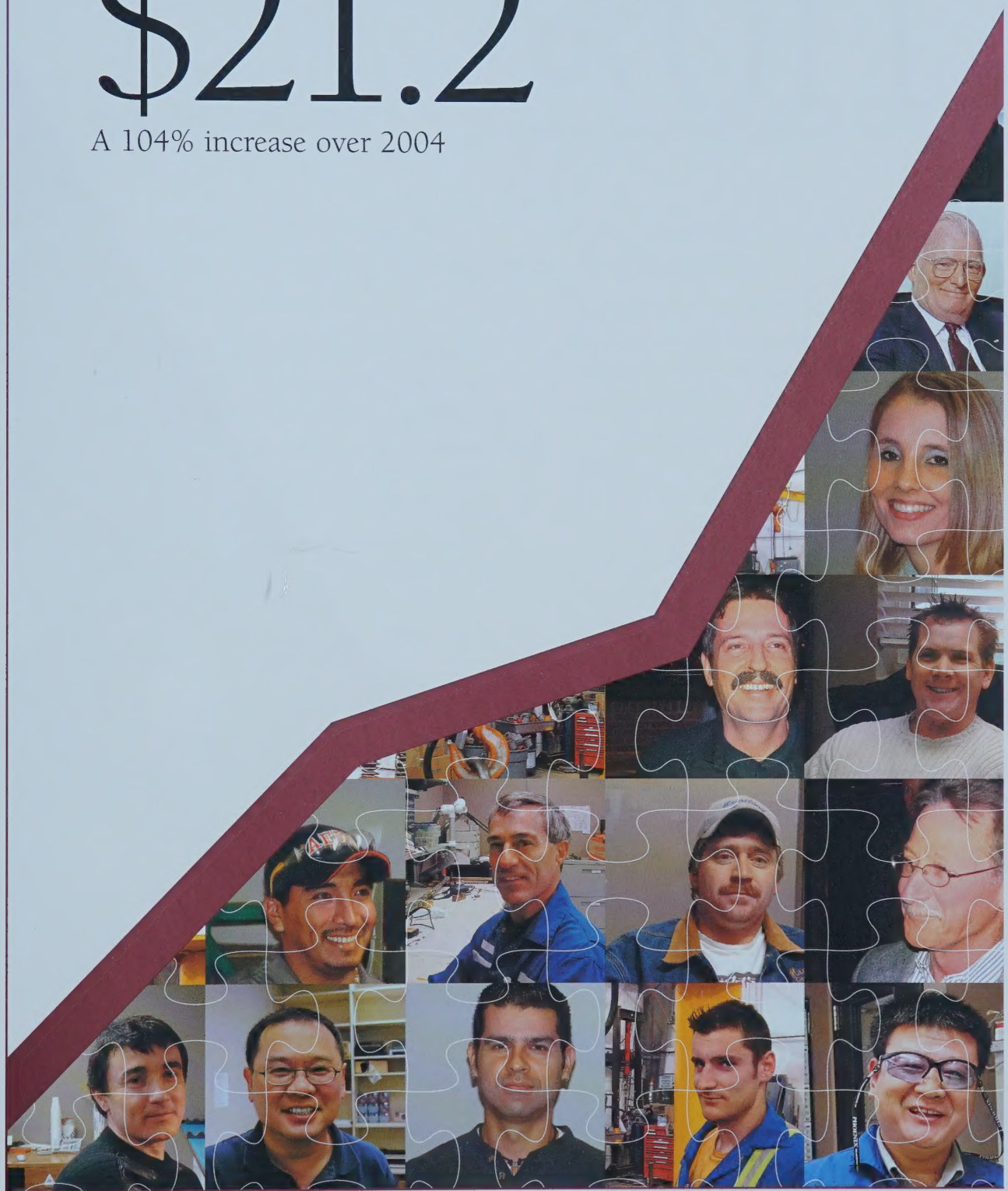
The two most common methods of transmitting this data remain mud-pulse telemetry and electro-magnetic or "EM" telemetry. For high-performance directional drilling, the driller at surface must have an accurate, reliable, and timely stream of information from the sensors at the bottom of the well. A mud pulse telemetry tool measures the downhole parameters and encodes them into a series of pressure pulses that travel up the inside of the drill pipe. These pulses are then decoded on surface. Information is displayed on a LCD screen on the drill floor and the driller is presented with real-time data.

An EM telemetry tool works by using similar downhole electronic equipment to measure and encode data. However, rather than use mud pressure to transmit the information, the EM tool uses the rock formation as part of a sophisticated alternating current electric circuit. As electricity flows in its circuit from the EM tool it can be measured on surface by a series of antennae. Digital data is turned into measurement information on the surface.

Cash Flow from Operations ($ millions)

$21.2

A 104% increase over 2004



Year End 2002
$2.0

Year End 2003
$8.5

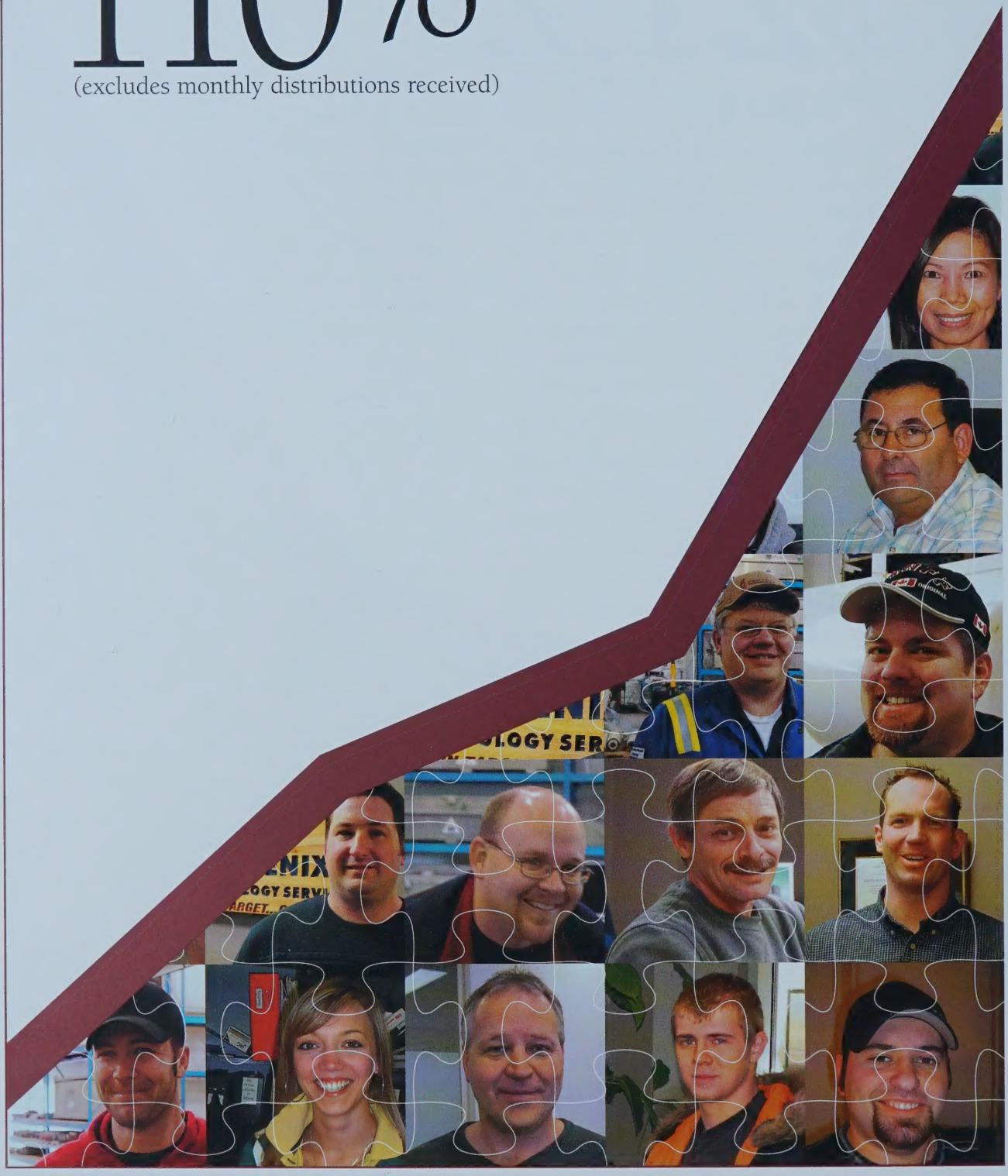
Year End 2004
$10.4

Year End 2005
$21.2

Unit Price Gains

110%

(excludes monthly distributions received)



Dec. 31, 2002	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005
$0.80	$3.35	$4.53	$9.51

President's Message

Phoenix was very successful in executing its business plan during this past financial year.

The Fund added capacity to its all of its operating segments in 2005 through capital acquisitions and through the manufacture of Current Loop Telemetry ("CLT") measurement while drilling ("MWD") guidance systems. This added capacity enabled the operating segments to meet the increasing customer demand that was realized through new and existing customers of Phoenix and as a result, record results were achieved in all financial areas.

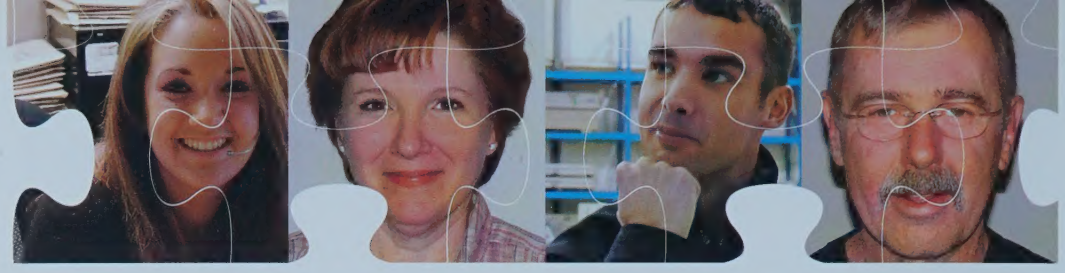
The industry fundamentals and conditions that were present in 2005 in both Canada and the United States were very favourable. The positive industry trends in 2005 included rising oil and natural gas commodity prices and strengthened demand for our services in all of our markets. I am pleased to report to our unitholders that the superior results that were achieved in 2005 are a tribute to the employees of Phoenix. The Fund was able to continue to deliver exceptional service and technology to our customers in a demanding environment.

Ultimately we are judged by our unitholders through the Fund's yearly unit price appreciation and through the level of cash distributions that are made. For the third year in a row I am happy to say that we delivered unit price gains. In 2005 alone, the Fund's unit price increased by 110 percent while at the same time our distributions paid to our unitholders increased twice in 2005. Cash distributions in 2005, in aggregate, increased from $0.04 per month to $0.05 per unit per month, a 25 percent increase. Phoenix exited the year paying annualized cash distribution totaling $0.60 per fund unit. Due to continued strong financial results, the Fund again increased its monthly distributions from $0.05 per unit to $0.065 per unit, or 30 percent, to be paid to unitholders on April 14, 2006.

2005 HIGHLIGHTS

Financial

The financial results achieved in the fourth quarter and the 2005 year were at all time



record levels for the Fund. Revenue for the year increased to $69.5 million, EBITDA reached $21.3 million, and cash flow, which the Fund pays particular attention to, was up 102 percent to $21.2 million.

Our US operating segment has continued to realize solid growth over the past two years. Revenue increased 89 percent to $25.1 million in the 2005 year as compared to 2004, and over a two-year period we have seen their revenue grow by 192 percent. In the 2004 year, the Canadian segment revenue growth was 14 percent. This year we are pleased to report that this segment in 2005 achieved revenue growth of 46 percent.

Operating and Marketing

Our financial results and profitability result from our operational efficiencies and our performance that we can deliver to our customers. We excelled in both of these areas in the year. In addition, the Fund built a further fifteen CLT EM MWD systems in 2005. This, coupled with a business acquisition, increased the company's concurrent job capacity by 42 percent, from 50 to 71 MWD systems. In spite of a significant increase in this job capacity the Fund was able to increase it's system utilization to 41 percent in 2005 as compared to 39 percent in 2004.

Phoenix was successful in adding to both of its Canadian and American client bases in 2005 while achieving greater customer diversification. Our largest customer made up less than seven percent of consolidated 2005 revenue, and our top five customers in aggregate in 2005, represented less than thirty percent of consolidated revenue.

Technology

Since the inception of our Research and Development ("R&D") division, Phoenix has separated itself from many of the conventional horizontal and directional service providers in the industry. One of our major successes has been the development of our CLT technology.

The expenditures required to run our R&D facility in 2005 totaled $0.6 million. These expenditures related to ongoing developments in our Inclination at Bit technology, which is required for SAGD drilling applications and CLT system operating software upgrades. Our R&D successes in the 2005-year include the initial commercialization of our high voltage CLT EM system that is designed for under balanced drilling applications and the drilling of deeper wells. In addition, the development of gamma logging software will help eliminate our dependence on costly third party offerings and reduce operating costs in 2006.

Phoenix's R&D division is, at any given time, working on additional projects that are expected to provide the Fund with competitive advantages that will further differentiate Phoenix from its competitors. The Company will remain committed to providing resources to this division, and look forward to further developed technologies that will complement our financial results in 2006.

Employees

In our current active industry environment it is very important to retain and attract employees at all levels. Our marketing and operations teams are consistently providing the highest level of support to our clients. We were successful in attracting and retaining operating field personnel in 2005, despite the presence of labour shortages throughout the industry. Phoenix increased its field personnel from thirty-six in 2004 to sixty-four in 2005. Our total personnel throughout the Organization increased from ninety-eight in 2004 to one hundred and forty-two by the end of 2005. These personnel numbers do not include Phoenix's field consultants that are used on a regular bais. Due to the critical importance placed upon qualified personnel in our sector Phoenix will continue to provide a positive, challenging and attractive work environment for all staff.

I would like to take this opportunity to thank the Board of Directors, management, and all employees and consultants of the Phoenix Technology Income Fund for all of their hard work and dedication that has allowed Phoenix to be a success.

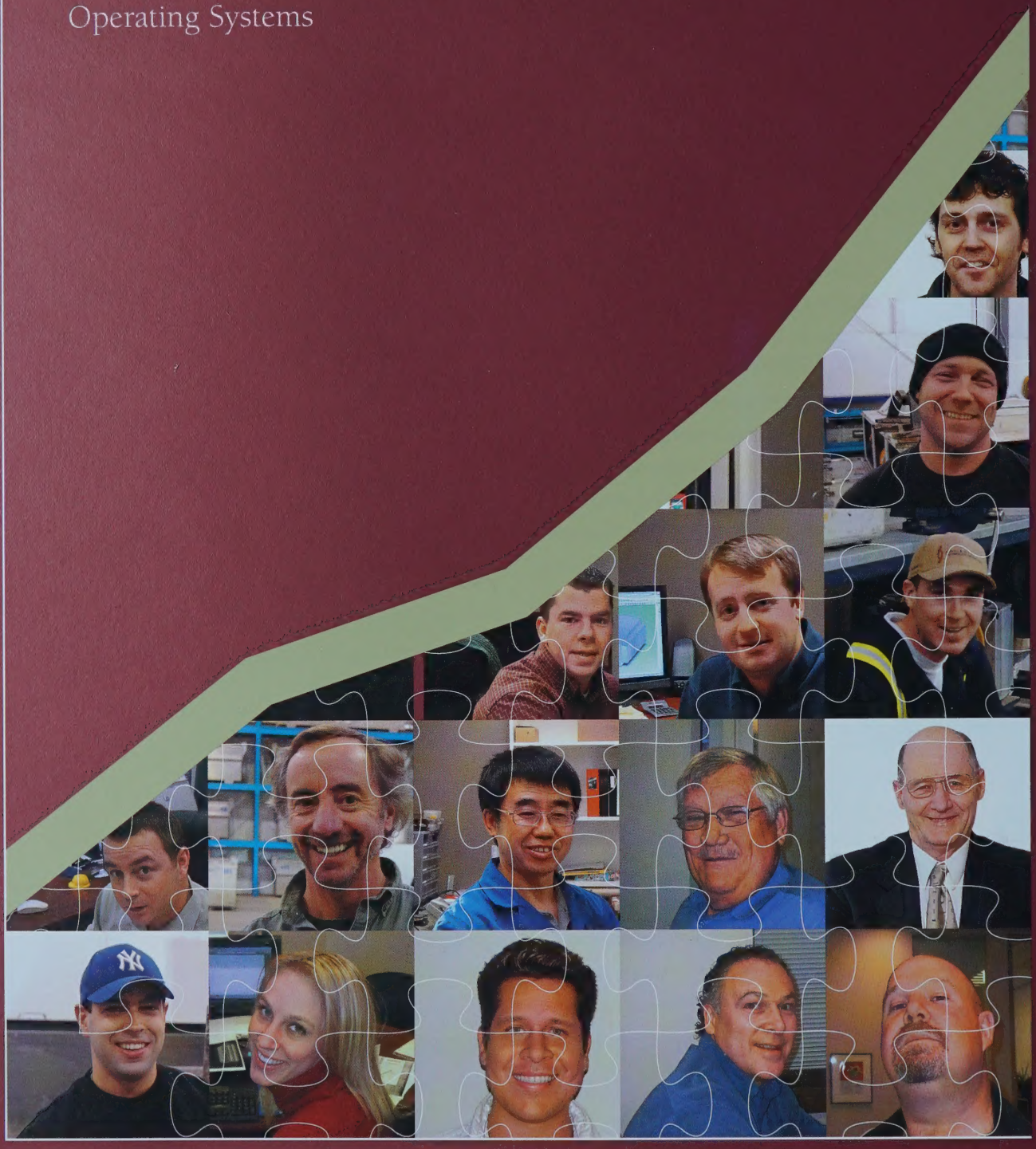
On behalf of the Board of Directors,

John Hooks
President and Chief Executive Officer
February 22, 2006

Operations Review

Building the Equipment Fleet

In 2005 Phoenix added 21 MWD Operating Systems, which included 15 new CLT EM MWD Operating Systems



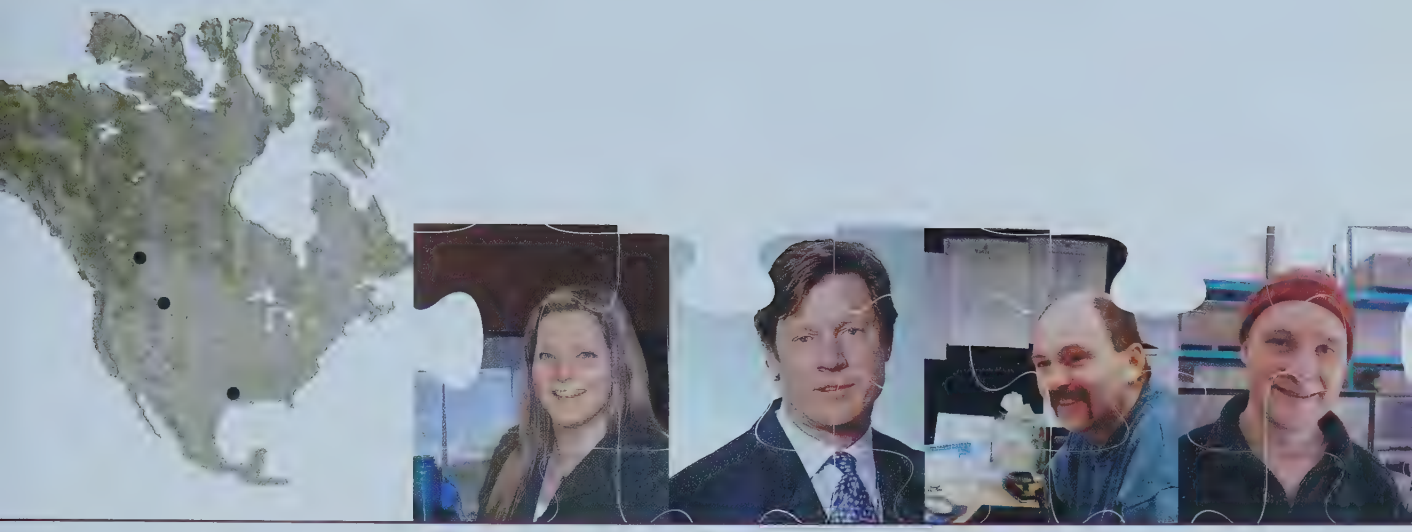
Year End 2001
17 Systems

Year End 2002
31 Systems

Year End 2003
33 Systems

Year End 2004
50 Systems

Year End 2005
71 Systems



CANADIAN SEGMENT

Phoenix Technology Services LP

Headquartered in Calgary, Alberta, the Canadian MWD operations provide horizontal and directional drilling services to oil and gas companies across western Canada. Phoenix Technology Services LP provided services for more than thirty new clients in 2005, improving its client diversification.

JAG Rentals

JAG Rentals, a wholly-owned division of Phoenix Techology Services LP, rents downhole equipment to oil and gas companies operating in western Canada. Rentals are on an hourly or daily basis for such tools as performance downhole drilling motors, drilling jars, shock tools, and stabilizers. The division is based out of its own facility in Calgary, Alberta.

UNITED STATES SEGMENT

Nevis Energy Services Inc.

Nevis Energy Services Inc., has reported outstanding growth since it was acquired by Phoenix in late 2002. Nevis provides fully-staffed directional and horizontal drilling services as well as MWD rentals to companies throughout the US including Texas and the Rocky Mountain states of Colorado and Wyoming. The head office and main service facility is located in Houston, with an additional service and sales facility located in Casper, Wyoming. 2005 was the first full year of operations for Nevis' Casper facility. Operations were set up in Casper to take advantage of the active drilling market in the Rocky Mountain regions of Colorado, North Dakota and Wyoming.

Technologies at a Glance

Current Loop Telemetry ("CLT")

In addition to the mud pulse technology that Phoenix possesses, the Phoenix developed CLT tool is an advanced EM system that has several operating benefits over these tools. In addition to being faster than mud pulse systems, the CLT tool will transmit downhole data while the mud pumps are off. This allows surveys to be taken while rig crews are performing connections, and saves valuable rig-time. Another important advantage of electro-magnetic CLT technology is the ability to transmit data in an under-balanced drilling operation. Underbalanced drilling is becoming an increasingly important technology in which an air-liquid mixture, rather than conventional drilling mud, is used to drill the well. This is done so that damage to hydrocarbon producing formations can be avoided. The compressible nature of these drilling mediums means that conventional mud-pulse telemetry systems will not work. Not only will the CLT tool operate in this environment, but its complete lack of moving parts, rugged electronics, and specialized mounting system makes it is much less susceptible to damage caused by intense vibration that accompany underbalanced drilling.

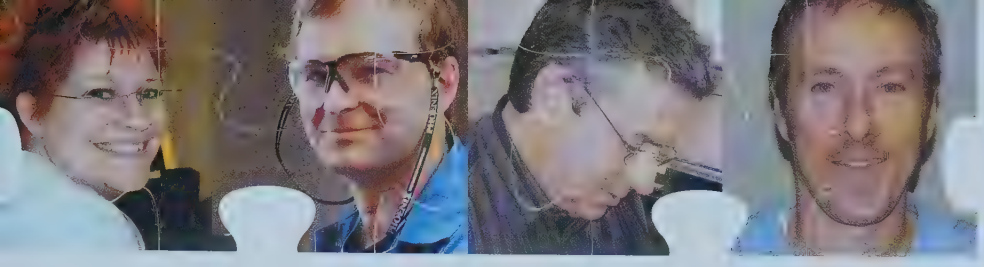
AutoSurvey

Because of the increased pressure to drill vertical wells even faster and more economically than ever before, the need has arisen to provide clients with fast and accurate bottom hole surveys in a more economical method than has been currently available. In a vertical application a client may not need constant updates while drilling, and periodic surveys are all that are required. The AutoSurvey tool consists of a simplified electronic sensor package and a revolutionary design of mud pulser that allows operators to drill wells with less downtime, less hands on location, and less cost. Phoenix added ten AutoSurvey systems to its equipment fleet with its recent acquisition of assets from Wellco's directional drilling division.

Technologies Under Development

Inclination at the Bit

The Inclination at the Bit technology will allow more responsive steering of directional and horizontal wells by supplying data from closer to the bottom of the well bore. Because of various physical constraints, MWD tools must be located from ten to twenty meters behind the drill bit. Inclination at the Bit will put sensors within one



meter of the drill bit, and will drastically reduce the amount of estimation required to drill a well to a certain location. Inclination at the Bit is an essential technology for breaking into the growing SAGD market because of the extremely tight tolerances that a directional driller must face. Initial field tests on the Phoenix developed technology have been positive, and further development and field trials will continue into 2006.

Extended Reach

Certain rock formations or well designs can cause a reduction in the transmission of a CLT signal. In these cases it is preferred to send out signal from a location up from where the CLT tool is taking its measurements. The Extended Reach addition for the CLT tool accomplishes this by providing a long extension antenna to allow transmission from as little as twenty meters to as much as several thousand meters up the drill string. Successful commercial runs have been achieved, and with modifications made to lengthen the antenna and strengthen the system, Phoenix is poised to perform additional commercial runs in underbalanced applications in 2006.

Coil Tubing Bottom Hole Assembly "BHA" Orienter

With more wells being drilled by coil tubing units the need for a dependable method of performing directional drilling with these units is required. Because a coil tubing string cannot be rotated to orient the bent-housing motor that steers a directional well, there must be some other device present for adjusting the orientation of that motor. Phoenix is addressing this need with the development of a Coil-Tubing Orienter. The Orienter is a mechanical device that indexes the BHA around to a desired position for steering. Measurements would be taken by an MWD tool until a need arises to activate the tool and steer the well in a different direction. The Orienter will then lock-in its new orientation allowing drilling to continue. Preliminary field-testing of these units is expected to take place by the end of 2006.

The following management's discussion and analysis ("MD&A") of the financial condition, results of operations, and cash flow of the Phoenix Technology Income Fund ("Phoenix" or the "Fund") should be read in conjunction with the Fund's annual audited Consolidated Financial Statements for the year's ended December 2005 and 2004, and the accompanying notes contained therein, as well as other sections contained within the Fund's 2005 annual report. Readers can also obtain additional information on the Fund including its Information Circular and Annual Information Form ("AIF") on SEDAR at www.sedar.com. This MD&A has been prepared taking into consideration information available up to and including February 22, 2006.

The MD&A focuses on key information and statistics contained within the consolidated financial statements, and the oil field services industry in western Canada and the United States which contain known and unknown risks and uncertainties. It should be noted that this MD&A would exclude any changes that may occur in economic, political and environmental conditions in both Canada and the United States. This MD&A contain statements that are not historical in nature and are forward-looking. These forward-looking statements include statements relating to Phoenix's plans, strategies, objectives, expectations, intentions, resources and business activities which are not guarantees as to future results since there are inherent difficulties in predicting these future results. The use of any the words: "anticipate", "expect", "project", "may", "will", "should", "believe", "estimate", "forecast", "intends" and similar expressions identify forward-looking statements. Such statements are subject to unknown risks and uncertainties, many of which are beyond the Fund's control. These would include the impact of the general state of the economy, oil and natural gas energy price fluctuations, industry conditions, competition from other organizations, weather conditions and the seasonal nature of business, access to third party suppliers and contractors, changes in government regulation, access to competent employees including senior management, and currency and interest rate fluctuations. The Fund's assumptions used in these forward-looking statements are believed to be reasonable at the time of preparation, however no assurance can be given that these assumptions will prove to be correct and consequently, the Fund's actual results could differ materially from those implied by or contained in any forward-looking statement. As a result readers should be cautioned about placing any undue reliance on any forward-looking statement included in this report.

Non generally accepted accounting principles ("GAAP") measures

The Fund uses earnings before interest, taxes, and depreciation ("EBITDA"), EBITDA per unit, cash flow from operating activities before net changes in non-cash working capital ("cash flow"), cash flow per unit and cash distributions per unit as financial performance measures that are not recognized under GAAP. Management believes that these measures provide supplemental financial information that is useful in the evaluation of the Fund's operations. Investors should be cautioned however, that these measures should not be construed as alternatives to measures determined in accordance with GAAP as an indicator of Phoenix's performance. Phoenix's method of calculating these measures may differ from other organizations, and accordingly, these may not be comparable. Refer to the Non-GAAP measures section at the end of this MD&A for a reconciliation of each non-GAAP measure referred to above to a measure defined under GAAP.

DESCRIPTION OF BUSINESS

Phoenix is a provider of horizontal and directional technology and drilling services in western Canada and the United States ("US"). The Fund also provides the western Canadian oil and natural gas service industry with down hole high performance drilling motors, drilling jars, shock tools, and stabilizers through its JAG Rentals division. Current Loop Telemetry ("CLT") guidance systems that were developed in Phoenix's research and development center are manufactured in house and made available for use in the Fund's operations, and for short term leases to other horizontal and directional service providers within the industry. Phoenix maintains sales, service and operational centers in Calgary, Alberta, Houston, Texas, and Casper, Wyoming. The Fund's Head Office and Research and Development centers are both located in Calgary.

During the 2005 year, Phoenix added twenty-one measurement-while-drilling ("MWD") guidance systems to its fleet, an increase of 42 percent from December 31, 2004. Of the additional systems added, fifteen were manufactured CLT units and six were positive pulse units that were acquired as part of an acquisition (refer to "Acquisition" section). As at December 31, 2005, the Fund had the capability of running seventy-one concurrent jobs, with forty-seven guidance systems deployed in Canada and twenty-four in the United States. Two additional mud pulse systems that were scheduled for field deployment in 2005 will be now added to the fleet during the first quarter of 2006 due to late component deliveries. It is expected that a minimum of ten additional CLT systems will be manufactured and placed into service in 2006 to keep pace with the Fund's growth and customer demand. By the end of 2006, the Fund anticipates the MWD guidance fleet size will be at a minimum of eighty-three, of which forty-three will be CLT units.

2004 INCOME FUND REORGANIZATION

On June 18, 2004, the shareholders and optionholders of Phoenix Technology Services Inc. ("PTSI") approved a Plan of Arrangement to reorganize Phoenix into the Phoenix Technology Income Fund, effective July 1, 2004. The reorganization was to improve Phoenix's access to capital, to finance future growth and acquisitions, and to provide unitholders with greater liquidity and flexibility with their participation in cash flows generated in the Fund.

The Plan of Arrangement, dated May 19, 2004, was entered into by the Fund, PTSI, Phoenix Commercial Trust ("PCT") and Phoenix Acquisition Corp. ("PAC"). Pursuant to section 193 of the Alberta Business Corporations Act, the Plan of Arrangement resulted in the amalgamation of PTSI and PAC, with the successor Company named Phoenix Technology Services Inc. PTSI is a wholly owned subsidiary of PCT and PCT in turn, is a wholly owned trust of the Fund.

As a result of the reorganization, each PTSI shareholder received one (1) unit of the Fund for each common share of PTSI held. A total of 18,589,855 common shares of PTSI were exchanged for the same number of units in the Fund. All optionholders exercised their vested options to acquire PTSI shares prior to the reorganization. A total of 455,609 unvested options held by optionholders to acquire PTSI shares were automatically exchanged for options to acquire units of the Fund on substantially the same terms and conditions.

OVERALL PERFORMANCE

In 2005, Phoenix completed its first full year of operations as an income fund. For the year ended December 31, 2005, the Fund achieved record activity levels and financial results in all areas. Revenue in the 2005 year increased to $69.5 million or by 58 percent as compared to $43.8 million in the 2004 year. Canadian segment revenue in 2005 increased by 46 percent to $44.4 million, as compared to $30.5 million in 2004. The US segment increased its 2005 revenue to $25.1 million or 89 percent from $13.3 million in 2004. The Fund continued to increase its job capacity throughout the year in order to meet the increasing service demand placed upon Phoenix from new and existing customers. In this regard, Phoenix incurred $9.4 million in capital expenditures in the 2005 year, and completed a business acquisition for $4.7 million.

Net earnings increased by 122 percent to $14.1 million, $0.66 per unit diluted in 2005, as compared to $6.3 million, $0.34 per unit diluted in 2004. For 2005, cash flow increased to $21.2 million, $1.00 per unit diluted, as compared to $10.5 million, $0.57 per unit diluted, a 102 percent increase. The cash payout ratio, which is defined as cash distributions divided by cash flow in 2005, was 51 percent. Cash distributions in the 2004 year did not commence until July 2004 upon the formation of the Fund and the cash payout ratio for that period was 43 percent.

Due to the strength of its cash flows, the Fund raised its cash distributions paid to unitholders on two occasions. In 2005, distributions were increased by 12.5 percent to $0.045 per month per unit for the July 15 distribution and raised again by 11.1 percent to $0.05 per month per unit for the December 15 distribution.

On February 22, 2006, the Fund approved an increase in its monthly cash distributions by 30 percent to $0.065 per unit from $0.05 per unit. This equated to an annualized payout to $0.78 per unit from $0.60 per unit. This increase will be effective for the Fund's March distribution that will be payable on April 14, 2006.

Unitholder's equity increased from $39.4 million in 2004 to $53.6 million in 2005. The increase related primarily to the issue of 1.2 million units under a short form prospectus for net proceeds of $10.4 million, net earnings generated from the Fund of $14.1 million, net of cash distributions of $11.1 million.

Business Acquisitions

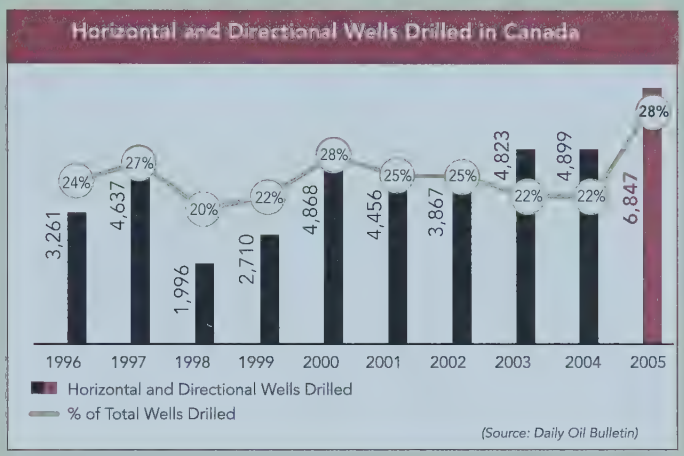
On October 21, 2005, Phoenix completed the purchase of the assets and business of the directional drilling division of Wellco Energy Services Partnership ("Wellco") for a cash consideration of $4.7 million. In addition to the cash consideration paid, $250,000 was placed in trust, and it is releasable to the vendor if certain assets meet set operational criteria over a future period. From this acquisition, Phoenix immediately added six positive pulse guidance systems, thirty-one down hole mud motors, ten auto survey systems and numerous other ancillary equipment to its fleet in time for the busy winter drilling season.

In March 2004, Phoenix completed the purchase of the assets and business of a private horizontal and directional drilling services company, Radius Directional Services Ltd. and it's wholly owned subsidiary Radius Directional Services Inc. (collectively, "Radius"). The operating results of Radius were included in the consolidated operating results of Phoenix from March 9, 2004. The aggregate consideration for the acquisition was $10.8 million, consisting of approximately $5.5 million in cash, the assumption of $1.8 million in debt, and the issuance of 1.15 million common shares of Phoenix at an ascribed price of $3.05 per share.

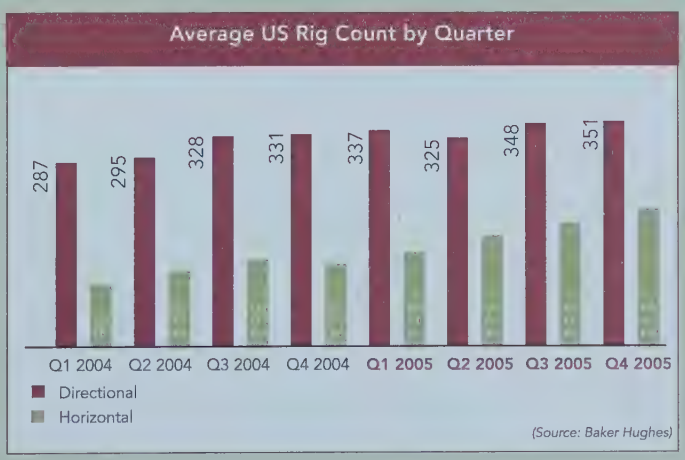
Key drivers of the Fund's business

Oil and natural gas prices, which are largely determined by supply and demand forces, dictate the levels of cash flows of our customers who are exploration and production ("E&P") companies. When world commodity price levels are high, the margins and cash flows of these companies are strong and there is a large incentive for them to conduct exploration and development drilling activities. The ability of our customers to finance their capital expenditure programs through debt or equity issues, and the current production levels of current reserves also contributes to the level of demand for services placed upon horizontal and directional drilling service providers such as Phoenix. Any sustained reduction in commodity prices could have a significant adverse effect on the Fund's net earnings and cash flows.

Average 2005 oil prices, as measured by West Texas Intermediate spot price and average natural gas prices as measured by the New York Mercantile Exchange, were up 36 percent and 46 percent respectively over 2004 to US $56.60 per barrel and to US $8.995 per Mcf (Source: Peters & Co. Limited).



With these increases in commodity prices in 2005, capital expenditure programs of E&P companies also increased, resulting in increased drilling activity in Canada and the United States in 2005. The number of wells drilled in Canada in 2005 was 24,789, of which 6,847 or 28 percent were horizontal or directional wells. This compares to 2004 where 22,688 wells were drilled, of which 22 percent, or 4,899, were drilled either horizontally or directionally. The Canadian chart above depicts the number of horizontal and directional wells drilled in Canada and the ratio of horizontal and directional wells drilled to total wells drilled for the last ten years. The increase in the ratio of horizontal and directional wells over total wells in 2005 is a result of a number of factors including an increase in the number of Steam Assisted Gravity drainage ("SAGD") and Coal Bed Methane ("CBM") wells that are being drilled using horizontal drilling technologies.



The average rig count in the US for horizontal and directional wells has increased for each quarter in 2005 as compared to each 2004 quarter, again as a result of increased oil and natural gas prices. Refer to US chart opposite.

People, equipment reliability, and service, along with the ability to develop and deploy new technologies, continue to be key elements necessary to be successful as a service provider within the industry. The Fund's ability to attract, train, and retain key personnel will directly influence its ability to continue to increase its market share. Developing and deploying new technologies to allow the Fund to further participate in SAGD and CBM drilling markets are also necessary to service the increasing demands from E&P companies and complement the Fund's future growth.

SELECTED ANNUAL FINANCIAL INFORMATION

The following selected annual financial information was obtained from the audited consolidated financial statements prepared in accordance with GAAP:

(Stated in thousands of dollars except per unit amounts) Years ended December 31,	2005	2004	2003
Revenue	**69,483**	43,846	35,343
Net earnings	**14,063**	6,342	4,258
Earnings per unit – basic	**0.67**	0.35	0.25
Earnings per unit – diluted	**0.66**	0.34	0.25
Long-term debt (1)	**1,775**	3,275	3,500
Total assets	**68,632**	52,554	42,489

(1) Excludes current portion of long-term debt.

The Fund's revenue increased by 58 percent to $69.5 million in 2005 from 2004, and by 24 percent to $43.8 million in 2004 as compared to 2003. The Fund has been successful in gaining market share in 2005 and 2004 as a result of obtaining new E&P clients in both the Canadian and American markets, and delivering the highly sought after CLT technology to our clients. The increased demand for the Fund's services in 2005 and 2004 was met by the continual strategy of increasing job capacity through two means, namely the manufacture of additional CLT tools, and by a business acquisition that occurred in both 2005 and 2004.

Phoenix's net earnings for the year ended December 31, 2005, increased to $14.1 million, $0.66 per unit diluted in 2005 from $6.3 million, $0.34 per unit diluted, in 2004 or 122 percent. Net earnings increased in 2004 by 49 percent as compared to 2003. The increase in 2005 net earnings is a result of the increase in activity in both geographical segments and increased profitability through improved gross profit margins.

Long-term debt repayments of $1.5 million were made in the 2005 year resulting in a balance at December 31, 2005, of $1.78 million. In 2004, the Fund issued additional long-term debt of $1.5 million to assist with the financing of the Radius acquisition.

Phoenix's total assets have increased steadily since 2003 to $68.6 million in 2005. The increase in total assets from 2004 to 2005 of 31 percent is due to the growth achieved through operations, an acquisition and an equity financing.

RESULTS OF OPERATIONS

Financial Highlights

(Stated in thousands of dollars except per unit amounts and units outstanding) Years ended December 31,	2005	2004	% change
Operating Results			
Revenue	**69,483**	43,846	58
Net earnings	**14,063**	6,342	122
Earnings per unit – diluted	**0.66**	0.34	94
EBITDA	**21,301**	11,354	88
EBITDA per unit – diluted	**1.00**	0.62	61
Cash Flow			
Cash flow	**21,236**	10,492	102
Cash flow per unit – diluted	**1.00**	0.57	75
Capital expenditures (1)	**9,390**	5,366	75
Cash distributions made (2)	**10,789**	4,464	142
Cash distributions per unit (3)	**0.515**	0.240	115
Cash payout ratio (4)	**51%**	43%	–
Financial Position, December 31			
Working capital	**18,217**	12,213	49
Long-term debt (5)	**1,775**	3,275	(46)
Unitholders' equity	**53,588**	39,426	36
Fund units outstanding	**22,120,564**	20,599,855	7

(1) Excludes business acquisitions.

(2) Phoenix commenced operations as an income fund and commenced making cash distributions to unitholders on July 1, 2004.

(3) Cash distributions on a per unit basis declared and paid to unitholders in the year.

(4) Phoenix defines its cash payout ratio as cash distributions made in the applicable period divided by cash flow for the same period.

(5) Excludes current portion of long-term debt.

Revenue

Phoenix generated record revenue of $69.5 million for the year ended December 31, 2005, which was 58 percent higher than revenue of $43.8 million in the 2004 year. The drilling industries in Canada and the US were very active in 2005. The Fund was successful in building its market share through the addition of several large and medium sized E&P clients through its continued strategic marketing efforts, the delivery of quality service, and the provision of CLT electro-magnetic technology which was highly sought after by the Fund's clientele. In conjunction with the increase in demand for the Fund's services, Phoenix continued to build its operating capacity in 2005. Twenty-one MWD guidance systems were added to the fleet in the current year, six systems came from the acquisition from Wellco that occurred in October 2005, and fifteen CLT systems were manufactured and placed in service by the end of 2005.

The Fund reports its operating segments on a geographical basis through the western regions of Canada and the gulf and rocky mountain regions of the US. Within the Canadian segment, the Fund had two operating divisions, MWD drilling services and JAG.

Due to the large increase in activity in 2005, the Fund was able to increase its consolidated MWD guidance equipment utilization for the year to 41 percent based on an average of 51 systems deployed in that year, as compared to 39 percent, based on an average of 36 systems deployed in that year. Due to time requirements to service and mobilize equipment, Phoenix considers that the maximum achievable utilization rate for its operations to be 67 percent.

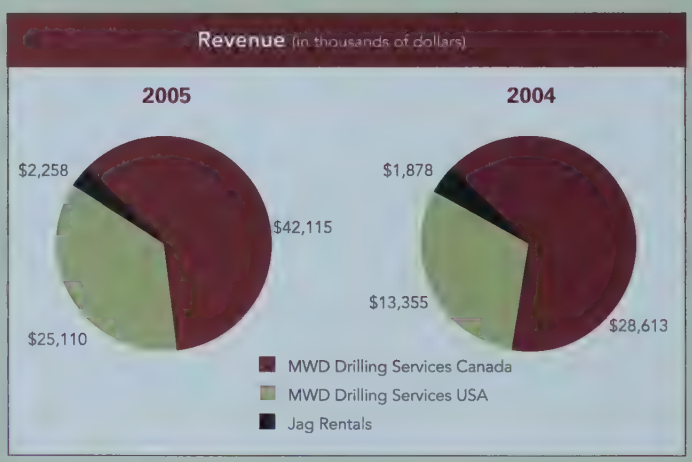
Canadian segment

Canadian segment revenue increased by 46 percent to a record $44.4 million for the year ended December 31, 2005, compared to $30.5 million in 2004. Within the Canadian segment, the MWD drilling services revenue was $42.1 million for the 2005 year, an increase of 52 percent, as compared to $27.7 million in 2004. In contrast, the number of wells drilled in western Canada in the 2005 year increased by 40 percent to 6,847 wells from 4,899 a year earlier. *(Source: Daily Oil Bulletin)* Phoenix provided services for more than thirty new clients in 2005, which improved its client diversification. As a result, there was less reliance placed by the Fund on any one customer in 2005 as compared to 2004. Due to the strong demand for services in 2005 in the industry, in both Canada and the US, day rates charged to customers late in 2005 increased by more than 10 percent. It is anticipated that similar increases may be realized by Phoenix in 2006. In 2004 additional Canadian segment revenue of $0.9 million was generated from the sale of two CLT kits that were made for a horizontal and directional service provider in the United States. Due to the greater long-term profitability achieved by the Fund by leasing these systems, there have been no sales of CLT systems in 2005.

The JAG rental division reported revenue of $2.3 million for the year ended December 31, 2005, as compared to $1.9 million in 2004, an increase of 21 percent. A further investment of $508,000 in capital equipment assisted JAG in increasing its revenue for both high performance mud motors and down hole drilling jars. In late 2005, JAG's operations and marketing were merged into the Canadian MWD drilling division in order to better co-ordinate marketing and operational activities. It is expected that this will result in increases in revenue and additional profitability to the segment in 2006.

United States segment

The operations in the US are conducted through the Fund's wholly owned subsidiary, Nevis Energy Services Inc. ("Nevis"). 2005 was the first full year of operations for Nevis through its new full service and sales facility in Casper, Wyoming. Operations were set up in Casper to take advantage of the active drilling market in the rocky mountain regions of Colorado, North Dakota and Wyoming. Nevis has been particularly active in the Barnett Shale



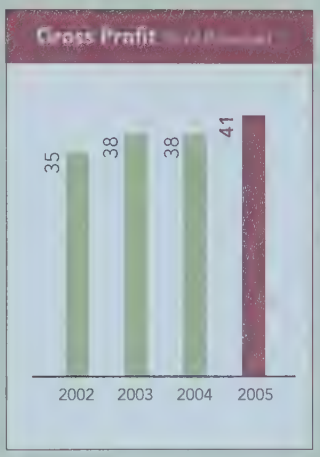
play in the Fort Worth, Dallas, and Denton areas of Texas, and has focused its 2005 activity on providing a greater proportion of full service work, as opposed to MWD rentals, to provide greater profitability. Nevis reported record revenue of $25.1 million in 2005, compared to $13.3 million in 2004, an 89 percent increase. It is expected for activity in these areas to remain strong into 2006 and the Fund will deploy additional systems in these areas based on client demand.

The US segment made up approximately 36 percent of consolidated revenue in 2005 as compared to 30 percent for the prior year. In 2006, it is anticipated that the US segment will make up a similar percentage of total revenue.

Operating Costs and Expenses

Direct costs

Direct costs are comprised mainly of field related and shop expenses but also include current period research and development expenditures. Direct costs for the year ended December 31, 2005, were $41.3 million as compared to $27.4 million, an increase of 51 percent. Included in direct costs are gross research costs of $636,000 in 2005 versus $664,000 in 2004. As a percentage of revenue, gross profit was 41 percent for the 2005 year, as compared to 38 percent for the prior year. Margins have improved in 2005, generally due to the higher volumes achieved by the Fund, increased day rates charged to customers, and lower equipment rentals incurred as a result of the large capital expenditure program in 2005. The Fund's strategy is to minimize third party down hole rentals wherever possible.



Selling, general and administration ("SG&A")

SG&A costs for the year ended December 31, 2005, were $7.5 million, as compared to $6.0 million, an increase of 25 percent. Included in the SG&A costs are $0.5 million of stock based compensation costs that relate to the issue of unit options in 2005. The corresponding amount in 2004 was $0.2 million. In addition, a provision for bad debts in the amount of $0.2 million was made against a US receivable in 2005. Excluding these non-cash costs, SG&A increased by 17 percent in 2005 compared to 2004 and was 10 percent of revenue in 2005 versus 13 percent in 2004. The increase in costs, in dollar terms, was generally due to higher selling and marketing related expenses that resulted from increased 2005 activity.

Depreciation and amortization

For the 2005 year, depreciation and amortization increased to $5.1 million from $4.0 million in 2004, an increase of 28 percent. Included in these amounts were amortization of intangible assets that arose on the Radius acquisition of $0.3 million in 2005, compared to $nil in 2004. The balance of the increase in depreciation results from the large capital expenditure program undertaken in 2005, and the Wellco acquisition.

Foreign exchange gains / losses

A net foreign exchange loss of $150,000 was reported for the 2005 year, compared to a net gain of $131,000 in the prior year. The gains and losses result from the translation of US and Canadian denominated trade receivables and payable balances, and movements in US and Canadian dollar exchange rates.

Interest on long-term debt

For the year ended December 31, 2005, interest on long-term debt decreased to $179,000 from $207,000 in 2004, or by 14 percent due to lower long-term debt levels carried in 2005.

Interest income

Interest income is generated from short-term money market investments from excess cash balances held. Interest income increased slightly from $106,000 in the 2004 year to $109,000 in 2005.

Gain on disposal of drilling equipment

The Fund realized a net gain on disposal of drilling equipment of $789,000 in the 2005 year, compared to $413,000 in the 2004 year. The disposals relate to insured equipment lost in well bores and are uncontrollable in nature. The gain reported is net of any asset retirements that are made before the end of their useful lives.

Reorganization costs

As a result of the corporate reorganization to an income fund in 2004, costs of $0.7 million were incurred and charged to operations in that year.

Provision against note receivable

A provision of $1.2 million was made in 2004 towards the full amount of a note receivable that related to the sale of assets in 2002. Its collection was tied to the purchaser obtaining a certain level of performance in the assets and this was not achieved in the time frame allowed.

Investment tax credits

During the 2005 year, the Fund recognized a $37,000 income benefit associated with investment tax credits, compared to $1,184,000 in 2004. Both of these tax credits were granted and assessed by Canada Customs and Revenue Agency in the respective years, and they related to prior years' scientific research expenditures made by the Fund. The portion of the investment tax credit associated with assets that were sold in 2002 was $1,039,000 in 2004 and $nil in 2005. This 2004 amount has been disclosed under the classification of investment tax credits on the statement of earnings. The balance of the investment tax credits received related to period expenditures and these amounts have been included under the classification of direct costs on the statement of earnings.

Income taxes

The provision for income taxes for the year ended December 31, 2005, was $2.1 million, as compared to a net recovery of income taxes of $0.3 million for the 2004 year. The effective rate for 2005 was 13 percent, as compared to an expected federal and provincial rate of 34 percent. The primary reason for the net variance arising from the different rates of $3.4 million, is due to the deductibility of declared cash distributions in calculating taxable income of the Fund. As an investment trust, the Fund is subject to income taxes under the Income Tax Act only on income not distributed to its unitholders.

EBITDA and net earnings

EBITDA for the year ended December 31, 2005, was a record $21.3 million, $1.00 per unit diluted as compared to $11.4 million, $0.62 per unit diluted, an 88 percent increase. Net earnings for 2005 was also a record for the Fund at $14.1 million, $0.66 per unit diluted, an increase of 122 percent from $6.3 million, $0.34 per unit diluted in 2004.

SUMMARY OF QUARTERLY RESULTS

(in thousands of dollars except per unit amounts)	Dec-05	Sept-05	Jun-05	Mar-05	Dec-04	Sept-04	Jun-04	Mar-04
Revenue	**21,646**	20,064	11,681	16,092	13,063	10,453	7,930	12,400
Net earnings (loss)	**4,810**	4,688	1,053	3,512	2,050	1,294	(33)	3,031
Earnings per unit – basic	**0.22**	0.23	0.05	0.17	0.11	0.07	0.00	0.18
Earnings per unit – diluted	**0.21**	0.22	0.05	0.17	0.11	0.07	0.00	0.17
Cash flow	**7,657**	6,596	2,172	4,812	4,072	2,117	281	4,022
Cash flow per unit – diluted	**0.33**	0.32	0.10	0.23	0.22	0.11	0.01	0.23

Activity levels in western Canada vary considerably due to seasonal weather patterns. Traditionally, the first quarter of the calendar year is historically the most active for service companies due to cold weather. The ability to move heavy equipment in the Canadian oil and natural gas fields is dependent on weather conditions. As warm weather returns in the spring, the winter's frost comes out of the ground rendering many secondary roads incapable of supporting the weight of heavy equipment until they have thoroughly dried out. The duration of this "spring break-up" has a direct impact on the Fund's activity levels. In addition, many exploration areas in northern Canada are accessible only in winter months when the ground is frozen enough to support equipment. The timing of freeze up and spring break-up affects the ability to move equipment in and out of these areas. As a result, late March through May is traditionally the Fund's slowest time, and as such the operating results of the Fund will vary on a quarterly basis. The Fund's activity levels in the US are not impacted during this Canadian spring break-up period.

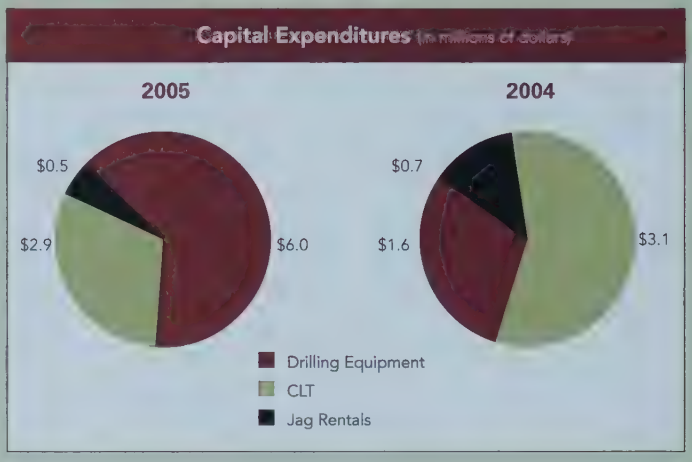
LIQUIDITY

Cash flow from operations

Cash flow from operations, before net changes in non-cash working capital, for the 2005 year was $21.2 million, $1.00 per unit diluted, compared to $10.5 million, $0.57 per unit diluted, an increase of 102 percent. The increase was generally due to higher earnings, depreciation and future income taxes in the 2005 year compared to 2004.

Investment

Net cash used in investing activities in the 2005 year was $11.6 million, compared to $9.9 million in 2004. The Fund invested a total of $9.4 million in drilling and other equipment of which, $2.9 million related to manufactured CLT units and $0.5 million related to rental equipment for JAG. In 2004, the Fund invested $5.4 million in equipment of which CLT units accounted for $3.1 million and JAG rental equipment accounted for $0.7 million.



The Fund realized proceeds from the involuntary disposal of drilling equipment in well bores of $2.3 million in 2005 as compared to $0.9 million in 2004.

In 2005 Phoenix invested $4.7 million cash in the Wellco business acquisition, and $5.5 million cash to assist with the financing of the $10.8 million Radius acquisition in 2004. A further $250,000 was placed in trust in 2005 for the Wellco acquisition, which will be released to the vendor if certain operational criteria are met over a future period.

Financing

The Fund had a negative cash flow from financing activities in the 2005 year of $1.7 million as compared to a positive cash flow of $0.8 million in the 2004 year. The Fund issued 1,200,000 units at a price of $9.00 per unit by way of a short form prospectus in October 2005, for gross proceeds of $10.8 million. Proceeds were used to assist the Fund with the financing of the Wellco acquisition and a portion of its future capital expenditure programs. In conjunction with the Fund's option plan 320,709 units were issued. In 2004 the Fund issued 2,000,000 units at $4.00 per unit on a bought deal basis on December 30, 2004, for gross cash proceeds of $7.7 million. The proceeds were used to finance Phoenix's capital expenditure program in 2005. A further 10,000 units were issued in 2004 pursuant to the Fund's option program.

In 2005 the Fund made long-term debt repayments of $1.5 million. In 2004 the Fund made long-term debt repayments of a total of $3.2 million; $1.8 million of this related to high interest yielding debt assumed from the Radius acquisition. In 2004 the Fund also issued long-term debt of $1.5 million to assist with the financing of the Radius acquisition.

During 2005, the Fund made distributions of $10.8 million to unitholders, or $0.515 per unit. Due to the strength of its cash flows, the Fund raised its cash distributions paid to unitholders on two occasions. Distributions were increased by 12.5 percent to $0.045 per month per unit for the July 15, 2004 distribution, and raised again by 11.1 percent to $0.05 per month per unit for the December 15, 2005 distribution. The cash payout ratio for the 2005 year was 51 percent. Phoenix commenced distributions to unitholders as an income fund on July 15, 2004, and for the period ending December 31, 2004, a total of $4.5 million or $0.24 per unit in cash distributions were made resulting in a part year cash payout ratio of 43 percent.

In 2004 the Fund reached a settlement with a group of predecessor Company shareholders who exercised their right of dissent under a Plan of Arrangement, and a final payment of $1.1 million, including costs and disbursements was made.

Working capital and liquidity

As at December 31, 2005 and 2004, the Fund had working capital of $18.2 million and $12.2 million respectively. Working capital was used throughout 2005 to assist with the financing of the Fund's capital expenditures and business acquisition and cash distributions. An equity financing in 2005 contributed $10.4 million to working capital. Phoenix anticipates that it will be able to fund its 2006 capital expenditure program through a portion of its cash flow from operations, its working capital, and the utilization of its unused debt capacity if required. It is also anticipated that the Fund can generate sufficient cash flow from operations to allow it to maintain its current cash distribution rate to unitholders.

Circumstances may arise that could adversely affect the Fund's cash flow from operations. These would include reduced capital spending by E&P companies and decreasing world oil and natural gas commodity prices. Refer also to the "Business Risk Factors" section. If an unexpected downturn in activity did occur, the Fund would react quickly to modify its capital expenditure program and strategies accordingly.

Activity levels in the industry are also seasonal, as discussed in the "Summary of Quarterly Results" section, and as a result, cash flow from operations will fluctuate. Cash flows from operations are usually expected to be highest in the first quarter of the year and lowest in the second quarter due to weather patterns.

CONTRACTUAL OBLIGATIONS

The Company has various contractual obligations outstanding that have been incurred in the normal course of operations:

	Total	1 Year	2-3 Years	4-5 Years
Long-term debt	$ 3,275,000	$ 1,500,000	$ 1,700,000	$ 75,000
Operating leases	2,813,353	827,854	1,110,579	874,920
Purchase obligations	2,335,712	2,335,712	–	–
Total contractual obligations	$ 8,424,065	$ 4,663,566	$ 2,810,579	$ 949,920

The purchase obligations are commitments that were outstanding as at December 31, 2005, for drilling and other equipment.

CAPITAL RESOURCES

The Fund has access to a demand revolving loan facility of up to $5.0 million. This facility would bear interest at the bank prime rate plus 0.375 percent. No amounts on the facility were drawn as at December 31, 2005. The Fund also has access to a revolving loan facility of up to $1,870,000 to be used to assist in the acquisition of capital assets. The loan would bear interest at the Fund's option at the bank prime rate plus 0.50 percent, or at the banks banker's acceptance rate plus a stamping fee of 1.25 percent. As at December 31, 2005, the Fund was in compliance with all of its bank debt covenants.

In addition to the $2.3 million in outstanding purchase obligations as at December 31, 2005, for capital equipment, the Fund plans to spend an additional $6.1 million in 2006 to expand its drilling fleet that will include a minimum of ten CLT systems, and various other down hole mud motors and equipment. It is anticipated that Phoenix will be able to fund its 2006 capital expenditure program through a portion of its cash flow from operations, its working capital, and the utilization of its unused debt capacity if required.

OFF BALANCE SHEET ARRANGEMENTS

The Fund had no off balance sheet arrangements as at December 31, 2005 and 2004.

TRANSACTIONS WITH RELATED PARTIES

During the year the Fund was charged $200,278, as compared to $623,977 in 2004 for the provision of various legal services from a director's firm of which he is a partner. In 2004 the Fund received $59,932 for various services performed and $10,600 for the sale of various capital equipment from companies controlled by an officer and major unitholder of the Fund. These transactions were completed in the normal course of operations on normal market terms and are measured at the exchange amounts.

FOURTH QUARTER

Financial Highlights (unaudited)

(Stated in thousands of dollars except per unit amounts and units outstanding) Quarter ended December 31,	2005	2004	% change
Operating Results			
Revenue	**21,646**	13,063	66
Net earnings	**4,810**	2,050	135
Earnings per unit – diluted	**0.21**	0.11	91
EBITDA	**7,290**	3,804	92
EBITDA per unit – diluted	**0.32**	0.21	52
Cash Flow			
Cash flow	**7,657**	4,072	88
Cash flow per unit – diluted	**0.33**	0.22	50
Cash distributions made	**3,037**	2,232	36
Cash distributions per unit	**0.14**	0.12	17
Cash payout ratio	**40%**	55%	–

Revenue

Due to Phoenix's increased capacity achieved in 2005, and the strong demand received for its services in the fourth quarter, revenue for the three-month period ended December 31, 2005, increased to a record level of $21.6 million, an increase of 66 percent from 2004 comparable period revenue of $13.1 million. Canadian segment revenue for the quarter ended December 31, 2005, was a record $14.5 million or 49 percent higher than $9.7 million for the 2004 period. Within the Canadian segment, MWD drilling services revenue increased 53 percent from $9.0 million in the 2004 quarter to $13.8 million in 2005. In comparison, the activity in Canada during the fourth quarter of 2005, measured by the number of horizontal and directional wells drilled, increased by 55 percent to 2,205 wells from 1,423 wells in the 2004 quarter. *(Source: Daily Oil Bulletin)*

JAG's revenue for the quarter ended December 31, 2005, was unchanged at $0.7 million, as compared to the 2004 quarter. Within the US segment, activity remained strong in both regional centers and revenue increased to $7.1 million in the 2005 quarter, from $3.4 million for the comparable 2004 quarter, an increase of 109 percent.

Operating costs

Gross profit, as a percentage of revenue, was 44 percent for the quarter ended December 31, 2005, as compared to 39 percent in 2004. The Fund invested $6.5 million in capital during the last two quarters of 2005 in order to increase its capacity and lower its third party rental expenses which both improved profitability. In addition, due to strong demand in the industry Phoenix was able to increase it's day rate prices to customers by approximately 10 percent in the quarter. SG&A costs for the quarter ended December 31, 2005, increased by 85 percent to $2.4 million, as compared to $1.3 million in the 2004 period. The increase in 2005 was due to the increased activity realized in the period, an increase in stock compensation expense of $0.3 million that related to the issue of unit options in the fourth quarter, and a bad debt provision of $0.2 million on a US receivable. As a percentage of revenue, SG&A increased slightly from 10 percent in the 2004 period to 11 percent in 2005. It is anticipated that going forward SG&A costs will be between 9 and 10 percent.

Due to the large amounts expended on drilling and other equipment in the second half of 2005, and the completion of the Wellco acquisition, depreciation expense increased by 50 percent to $1.5 million for the three months ending December 31, 2005, from $1.0 million in 2004.

Income taxes

For the quarter ended December 31, 2005, the Fund reported a provision for income taxes of $0.9 million, as compared to a net recovery of income taxes of $0.5 million in the 2005 quarter. The effective tax rate for the 2005 period was 16 percent.

EBITDA and net earnings

EBITDA for the three-month period ended December 31, 2005, was a record 7.3 million, $0.32 per unit diluted, compared to $3.8 million, $0.21 per unit diluted for the corresponding 2004 period, a 92 percent increase. Net earnings for the three-month period ended December 31, 2005, increased by 135 percent to a record $4.8 million, $0.21 per unit diluted, from $2.1 million, $0.11 per unit diluted. Included in net earnings for the December 2004 period was a provision taken against a note receivable of $1.2 million that related to the sale of some directional drilling assets in 2002. The collection of the note was tied to the future performance of the assets which did not occur. The after tax impact of this provision in 2004 was $0.9 million or $0.05 per unit diluted.

Cash flow from operations and cash distributions

Cash flow from operations, before net changes in non-cash working capital, for the three-month period ending December 31, 2005, was a record $7.7 million, $0.33 per unit diluted as compared to $4.1 million, $0.22 per unit diluted for comparable 2004 period, an increase of 88 percent. Cash distributions made to unit holders in the three-month period ended December 31, 2005, was $0.14 per unit or $3.0 million. The Fund raised its distribution by 11 percent from $0.045 per unit to $0.05 per unit effective for the December 15, 2005 distribution. This resulting cash payout ratio for the fourth quarter in 2005 was 40 percent. The Fund internally targets its annual payout ratio to be approximately 65 percent.

PROPOSED TRANSACTIONS

The Fund currently has no plans to make any material business acquisitions or capital asset divestitures. The Fund has plans to spend $6.1 million in capital acquisitions in 2006. Refer also to "Contractual Obligations" section.

CRITICAL ACCOUNTING ESTIMATES

The consolidated financial statements of the Fund are prepared in accordance with GAAP. The Fund's significant accounting policies are described under note one to these statements. Management, in preparing these financial statements, are required to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and judgments are based upon assumptions that are considered reasonable under the circumstances. Actual results could differ from such estimates and judgments by a material amount. The estimates and judgments used that are most critical to the reporting of the Fund's results of operations, cash flow, and financial position are as follows:

Revenue recognition

The Fund recognizes revenue as services are provided. The Fund's services are sold based upon bid acceptances of contracts with customers that include fixed or determinable prices base upon daily, hourly or job rates. Revenue is recognized when services or rentals are provided, and when collectability is assured.

Accounts receivable

The Fund's trade accounts receivable accounts are reviewed on an ongoing basis for collectability. The Fund makes an allowance for specific accounts that are deemed to be uncollectable. Due to the nature of exploration risks taken on by E&P companies, the ability of these companies to fulfill their obligations can change quickly, and the valuation of accounts receivable may become impaired.

Depreciation of drilling and other equipment

The Fund has estimated the useful lives and residual values of its drilling and other equipment. The Fund has also estimated the depreciation method that best reflects the utilization pattern of the various assets. These estimates can change as technological advancements are made within the industry, and adjustments may become necessary.

Long-lived assets

Management assesses the carrying value of long-lived assets on a periodic basis for indications of impairment. Indications of impairment include an ongoing lack of profitability and significant changes in technology. Due to technological advances that may occur in the industry in the future, long-lived assets could become impaired in subsequent periods.

Intangibles

The Fund has estimated the existence of, and provided a valuation for, other intangible assets on its past acquisitions. The identification and valuation of intangible assets was based on certain assumptions and analysis that the Fund deemed to be reasonable in the circumstances. The amortization of these assets are being charged to operations over the expected benefit periods.

Goodwill

Goodwill is not amortized, and is tested for impairment annually at the end of each financial year. Management of the Fund has determined that there has been no impairment on the carrying value of goodwill as at December 31, 2005. Due to the cyclical nature of the industry, goodwill valuations could be materially different in the future.

Income taxes

The Fund follows the liability method of accounting for income taxes. Under the liability method, future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Valuation allowances are taken against future tax assets when it is determined, that it is more likely than not, that the asset will not be realized in its entirety. The Fund has taken its forecasted future income tax liability into consideration in determining if a valuation allowance is required with respect to tax loss carry forward amounts. The Fund has also recorded benefits associated with investment and foreign business tax credits received. The Fund's forecasted future income tax liability was again considered in determining if these amounts would be realizable. Due to the cyclical nature of the industry, the Fund's future forecasted income tax liability could change, and the realization of these assets in whole or in part may not occur.

Translation of foreign subsidiary

The Fund's US subsidiary is accounted for as a self-sustaining operation. Accordingly, the subsidiary's accounts in foreign currencies and operations have been translated into Canadian dollars using the current rate method. Monetary and non-monetary items denominated in US dollars are translated to Canadian dollars at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average exchange rate for the month the transaction occurred. Gains or losses arising on translation are deferred and reported as a foreign currency adjustment as a separate component of unitholders' equity. Circumstances can change in the future whereby the subsidiary could be classified as fully integrated and, as a result, gains or losses arising on translation would be charged or credited against net earnings.

Stock based compensation

The Fund has a unit option plan that is described in note 10(c) to the annual audited financial statements. The fair value of each option granted is calculated using the Black-Sholes options pricing model using various assumptions. The use of different assumptions could materially alter the amount of stock based compensation expense charged against net earnings.

CHANGES IN ACCOUNTING POLICIES

There have been no changes in accounting policies subsequent to December 31, 2005, and no changes are anticipated. There were no new accounting policies adopted in the 2005 year.

FINANCIAL INSTRUMENTS

Credit risk

The Fund is exposed to normal credit risks of its customers that exist within the oil and gas exploration and development industry.

Fair values of financial instruments

The carrying values of accounts receivable, accounts payable and accrued liabilities, income taxes payable, and distributions payable approximate their fair value due to the relatively short periods to maturity of the instruments. The fair value of long-term debt included in the consolidated balance sheet approximates fair values as the indebtedness is subject to floating rates of interest.

Interest rate risk

The Fund manages its exposure to interest rate risk through floating bankers acceptance rate borrowings.

Foreign exchange risk

Due to operations of the Fund's subsidiary in the US, the Fund has an exposure to foreign currency exchange rates. Both the carrying values and earnings are subject to foreign exchange risk. Currently, there is no management program in place to mitigate this foreign exchange risk.

BUSINESS RISK FACTORS

Demand for services

Demand for the Fund's horizontal and directional drilling technology and services depends largely on the level of capital spending by oil and natural gas companies for exploration, development, and production activities in western Canada and the United States. No assurance can be given that current levels of oil and natural gas drilling activities will be maintained or increase, or that demand for the Fund's technology and services will reflect the level of drilling activities. As well, exploration and development drilling activities depend in large measure upon oil and natural gas prices that may be affected by local or international factors, or by governmental regulation that cannot be accurately predicted. The business of the Fund is directly affected by changes in the level of drilling activity carried on by its customers, which in turn is directly affected by fluctuations in world energy prices.

Competition

The Fund's major competitors are principally large multinational companies with significantly greater resources available for marketing and research and development programs. The Fund also competes with a number of other small and medium sized companies. Like the Fund, they have certain competitive advantages such as low overhead costs and specialized regional strengths. The Fund's ability to generate revenues depends on its ability to obtain contracts and to perform services within projected times and costs.

Access to equipment and development of new technology

The ability of the Fund to compete and expand is dependent upon it having access at a reasonable cost to certain drilling equipment and components, and to develop or acquire new competitive technology. The Fund will make its purchases of this equipment from time to time from various suppliers in the oil and natural gas drilling service industry. There can be no assurance that these sources for equipment will be maintained. If such equipment is not available, and is not available from any other source, the Fund's ability to compete may be impaired.

Employees

The success of the Fund will be dependent upon key personnel. Loss of the services of such persons could have a material adverse effect on the business and operations of the Fund. The ability of the Fund to expand its services is dependent upon its ability to attract additional qualified employees.

Oil and gas industry risks

There are risks associated with the provision of drilling services to the oil and natural gas industry. The Fund may become liable for risks against which it may choose not to insure due to high premium costs, or which may exceed the limits of policy coverage. Interruptions and delays caused by adverse weather conditions, equipment failures, and other events can significantly adversely effect revenues. While the Fund will maintain liability insurance, the insurance is subject to coverage limits. There can be no assurance that insurance will continue to be available to the Fund on commercially reasonable terms, that the possible types of liabilities that may be incurred by the Fund will be covered by its insurance, or that the dollar amount of such liabilities will not exceed policy limits. Even a partially uninsured claim, if successful and of sufficient magnitude, could have a material adverse effect on business, results of operations and prospects.

Seasonality

In general, the level of activity of the Canadian oilfield service industry is influenced by seasonable weather patterns. Wet weather and the spring thaw may make the ground unstable. Consequently, municipalities and provincial transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Additionally, certain oil and gas producing areas are located in areas that are inaccessible, other than during the winter months, because the ground surrounding or containing the drilling sites in these areas consists of swampy terrain known as muskeg.

Foreign operations

The Fund will conduct a certain portion of its business in the United States. Any changes in government policies could have a significant impact on business in the United States. Risks of foreign operations include, but are not necessarily limited to changes of laws affecting foreign ownership, government participation, taxation, royalties, duties, rates of exchange, inflation, exchange control, and repatriation of earnings. There are no assurances that the economic and political conditions in the countries in which the Fund operates will continue as they are at the present time. The effect of these factors cannot be accurately predicted.

OUTSTANDING FUND UNIT DATA

(in thousands of units)	As at February 22, 2006
Fund units – basic	22,147
Dilutive securities:	
Options	1,690
Fund units – diluted	23,837

CORPORATE GOVERNANCE

This MD&A has been prepared by the management of Phoenix Technology Services Inc., the administrator of Phoenix Technology Income Fund. The MD&A has also been reviewed and approved by the Audit Committee and Board of Directors of Phoenix Technology Services Inc. Additional information relating to the Fund's Corporate Governance can be found in the Fund's AIF and Information Circular that are filed on SEDAR at www.sedar.com.

OUTLOOK

Current industry forecast's for the number of well's drilled in 2006 in Canada and the United States are predicting increased activity over 2005. A significant portion of these wells, approximately 25 to 30 percent, will be drilled horizontally or directionally. Phoenix's strategy will focus on investing in drilling equipment and technology, including the manufacture of additional CLT units, and its recruiting process to hire highly qualified personnel in order to keep up with increased levels of activity that the Fund expects to generate in 2006. Expansion plans are also being tabulated for certain growth regions of the US, and certain operational initiatives are expected to assist the Fund with achieving increased profitability.

NON-GAAP MEASURES

a) The following is a reconciliation of EBITDA to net earnings:

(in thousands of dollars)	Years ended December 31 2005	2004	Quarters ended December 31 2005	2004
EBITDA as reported	**$ 21,301**	$ 11,354	**$ 7,290**	$ 3,804
Add:				
Interest income	**109**	106	**28**	13
Deduct:				
Depreciation and amortization	**(5,089)**	(4,007)	**(1,527)**	(1,045)
Interest on long-term debt	**(178)**	(207)	**(51)**	(47)
Provision against note receivable	**–**	(1,202)	**–**	(1,202)
	16,143	6,044	**5,740**	1,523
Provision for (recovery of) income taxes	**2,080**	(298)	**930**	(527)
Net earnings	**$ 14,063**	$ 6,342	**$ 4,810**	$ 2,050

Diluted EBITDA per unit amounts are calculated using the treasury stock method where deemed proceeds on the exercise of the unit options are considered to be used to re-acquire fund units at an average unit price. The calculation of EBITDA per unit on a dilutive basis does not include anti-dilutive options. The denominator used in the calculation of diluted EBITDA per unit is the same as diluted earnings per unit as shown in note 10(b) to the audited financial statements.

b) The following is a reconciliation of cash flow to cash flow provided by operating activities:

(in thousands of dollars)	Years ended December 31 2005	2004	Quarters ended December 31 2005	2004
Cash flow	**$ 21,236**	$ 10,492	**$ 7,657**	$ 4,072
Changes in non-cash working capital	**(9,882)**	(2,942)	**(4,879)**	(1,776)
Cash flow provided by operating activities	**$ 11,354**	$ 7,550	**$ 2,778**	$ 2,296

Diluted cash flow per unit amounts are calculated using the treasury stock method where deemed proceeds on the exercise of the unit options are considered to be used to re-acquire fund units at an average unit price. The calculation of cash flow per unit, on a dilutive basis, does not include anti-dilutive options. The denominator used in the calculation of diluted cash flow per unit is the same as diluted earnings per unit as shown in note 10(b) to the audited financial statements.

Management's Report to the Unitholders

The accompanying consolidated financial statements and all information in the Annual Report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with the accounting policies in the notes to financial statements. When necessary, management has made informed judgments and estimates in accounting for transactions which were not complete at the balance sheet date. In the opinion of management, the financial statements have been prepared within acceptable limits of materiality, and are in accordance with Canadian generally accepted accounting principles (GAAP) appropriate in the circumstances. The financial information elsewhere in the Annual Report has been reviewed to ensure consistency with that in the consolidated financial statements.

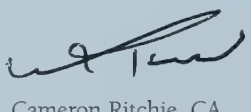
Management has prepared Management's Discussion and Analysis (MD&A). The MD&A is based upon the Fund's financial results prepared in accordance with Canadian GAAP. The MD&A compares the audited financial results for the twelve months ended December 31, 2005 to December 31, 2004.

Management maintains appropriate systems of internal control. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records properly maintained to provide reliable information for the preparation of financial statements.

KPMG LLP, an independent firm of Chartered Accountants, was engaged by Computershare Trust Company of Canada, trustee of the Fund, to audit the consolidated financial statements in accordance with generally accepted auditing standards in Canada and provide an independent professional opinion.

The Audit Committee of the Board of Directors of Phoenix Technology Services Inc., which is comprised of three directors who are not employees of the Corporation, has discussed the consolidated financial statements, including the notes thereto, with management and external auditors. The consolidated financial statements have been approved by the Board of Directors on the recommendations of the Audit Committee.

John Hooks
Chairman of the Board,
President and
Chief Executive Officer



Cameron Ritchie, CA
Senior Vice-President Finance
and Chief Financial Officer

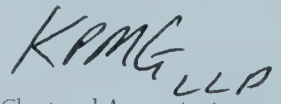
February 22, 2006

Auditors' Report to the Unitholders

We have audited the consolidated balance sheets of Phoenix Technology Income Fund as at December 31, 2005 and 2004 and the consolidated statements of earnings and retained earnings and cash flows for each of the years in the two-year period ended December 31, 2005. These consolidated financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2005 and 2004 and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2005 in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
Calgary, Canada
February 22, 2006

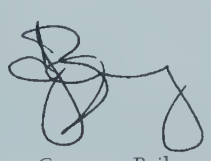
Consolidated Balance Sheets

December 31	2005	2004
Assets		
Current assets		
Cash and cash equivalents	$ 3,964,950	$ 5,933,924
Accounts receivable	24,481,382	12,307,097
Inventory	725,538	871,316
Prepaid expenses	488,246	448,722
Income taxes recoverable	–	265,200
	29,660,116	19,826,259
Drilling and other equipment (note 3)	29,807,982	22,163,871
Cash in trust (note 2a)	250,000	–
Intangibles (note 4)	37,500	300,000
Goodwill	8,876,351	8,876,351
Investment tax credit receivable	–	1,387,471
	$ 68,631,949	$ 52,553,952
Liabilities and Unitholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	$ 8,705,496	$ 5,289,273
Income taxes payable	132,000	–
Distributions payable (note 7)	1,106,028	823,994
Current portion of long-term debt (note 8)	1,500,000	1,500,000
	11,443,524	7,613,267
Long-term debt (note 8)	1,775,000	3,275,000
Future income taxes (note 9b)	1,825,411	2,239,200
	15,043,935	13,127,467
Unitholders' equity		
Unitholders' capital (note 10a)	43,377,923	32,386,415
Contributed surplus (note 11)	1,071,465	654,900
Foreign currency adjustment	(1,863,172)	(1,624,827)
Retained earnings	11,001,798	8,009,997
	53,588,014	39,426,485
	$ 68,631,949	$ 52,553,952

See accompanying notes to the consolidated financial statements.

Approved on behalf of Phoenix Technology Income Fund by Phoenix Technology Services Inc. as administrator:

John Hooks
Chairman of the Board



Cameron Bailey
Director

Consolidated Statements of Earnings

Years ended December 31	2005	2004
Revenue	$ 69,482,615	$ 43,846,449
Direct costs	41,335,972	27,400,521
Gross profit	28,146,643	16,445,928
Expenses		
Selling, general and administrative	7,484,971	6,017,126
Depreciation and amortization (notes 3 & 4)	5,089,049	4,007,341
Foreign exchange loss (gain)	149,611	(130,941)
Interest on long-term debt	178,813	207,120
Interest income	(109,201)	(106,100)
Gain on disposition of drilling equipment	(789,168)	(412,865)
Reorganization costs (note 12)	–	657,616
	12,004,075	10,239,297
Operating income	16,142,568	6,206,631
Provision against note receivable (note 13)	–	1,202,000
Investment tax credit income	–	(1,039,000)
Earnings before income taxes	16,142,568	6,043,631
Provision for (recovery of) income taxes (note 9a)		
Current	84,000	477,700
Future	1,996,000	(776,000)
	2,080,000	(298,300)
Net earnings	$ 14,062,568	$ 6,341,931
Earnings per unit – basic (note 10b)	$ 0.67	$ 0.35
Earnings per unit – diluted (note 10b)	$ 0.66	$ 0.34

Consolidated Statements of Retained Earnings

Years ended December 31	2005	2004
Retained earnings, beginning of year	$ 8,009,997	$ 8,024,293
Net earnings	14,062,568	6,341,931
Distributions (note 7)	(11,070,767)	(5,287,559)
Amounts paid in excess of assigned value on cancellation of common shares (note 10d)	–	(1,068,668)
Retained earnings, end of year	$ 11,001,798	$ 8,009,997

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31	2005	2004
Cash flows from operating activities		
Net earnings	$ 14,062,568	$ 6,341,931
Add (deduct) items not affecting cash		
Depreciation and amortization	5,089,049	4,007,341
Future income taxes	1,996,000	(776,000)
Unrealized foreign exchange loss (gain)	145,518	(40,190)
Gain on disposition of drilling equipment	(789,168)	(412,865)
Stock-based compensation (note 10c)	525,567	170,039
Bad debt provision	206,839	–
Provision against note receivable	–	1,202,000
	21,236,373	10,492,256
Change in non-cash working capital (note 14)	(9,882,291)	(2,941,702)
	11,354,082	7,550,554
Cash flows from investing activities		
Proceeds on disposition of drilling equipment	2,252,841	923,777
Acquisition of drilling and other equipment	(9,390,393)	(5,366,376)
Business acquisition (note 2)	(4,691,555)	(5,503,803)
Cash in trust (note 2a)	(250,000)	–
Change in non-cash working capital	432,278	–
	(11,646,829)	(9,946,402)
Cash flows from financing activities		
Issuance of units	10,612,508	8,040,868
Repayment of long-term debt	(1,500,000)	(3,226,396)
Distributions to unitholders' (note 7)	(10,788,735)	(4,463,565)
Issue of long-term debt	–	1,500,000
Dissenting shareholder disbursements (note 10d)	–	(1,068,668)
	(1,676,227)	782,239
Decrease in cash and cash equivalents	(1,968,974)	(1,613,609)
Cash and cash equivalents, beginning of year	5,933,924	7,547,533
Cash and cash equivalents, end of year	$ 3,964,950	$ 5,933,924
Supplemental information		
Income taxes received	$ 147,412	$ 64,023
Interest paid	$ 138,931	$ 174,546

See accompanying notes to the consolidated financial statements.

Notes to Consolidated Financial Statements

Years Ended December 31, 2005 and 2004

Phoenix Technology Income Fund (the "Fund") is an unincorporated open-ended investment trust governed by the laws of the province of Alberta pursuant to a Trust Indenture dated May 19, 2004 between Phoenix Technology Services Inc. ("PTSI") and Computershare Trust Company of Canada. Pursuant to section 193 of the Alberta Business Corporations Act, a Plan of Arrangement was entered into by the Fund, PTSI, Phoenix Commercial Trust ("PCT"), and Phoenix Acquisition Corp. ("PAC"), effective July 1, 2004, whereby PTSI amalgamated with PAC and the successor Company changed its name to Phoenix Technology Services Inc. (the "Company"). The Company is a wholly owned subsidiary of PCT, and PCT is in turn a wholly owned trust of the Fund. PTSI is the administrator of the Fund. Its powers are set out in an administration agreement between itself and the Trustee. The Trustee, on recommendation of PTSI, will declare payable to the Unitholders on the distribution record date, all or any part of distributable income out of the Fund's distributable cash. Distributable cash is defined as income received or reasonably entitled to be received, less all expenses and liabilities the Fund incurred or anticipated to be incurred.

The Fund through its subsidiaries and partnership provides horizontal and directional drilling services to the oil and natural gas industry in western Canada and the United States. The Fund also rents various drilling equipment to oil and natural gas companies in western Canada and manufactures technology for lease and internal use.

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Revenue recognition

The Fund recognizes revenue as services are provided. The Fund's services are sold based upon bid acceptances or contracts with customers that include fixed or determinable prices based upon daily, hourly or job rates. Revenue is recognized when services or equipment rentals are provided and when collectibility is assured.

(b) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand with commercial banks and investments in bankers acceptances issued by commercial banks and large corporations with an original maturity of three months or less.

(c) Inventory

Inventory, which consists of spare parts, is stated at the lower of cost and net realizable value, cost being determined on a specifically identified basis.

(d) Drilling, other equipment and depreciation

Drilling and other equipment are recorded at cost. Depreciation is provided over the estimated useful lives of the assets as follows:

Directional drilling equipment	4 to 8 years straight line, 0 to 20% residual value
Rental equipment	5 to 8 years straight line, 0 to 20% residual value
Office and computer equipment	3 to 5 years straight line
Machinery and equipment	5 years straight line
Vehicles	5 years straight line

(e) Research and development costs

Research costs are expensed as incurred. Certain product development costs are capitalized once market and technical feasibility has been established. Development costs capitalized are amortized on a straight-line basis over their estimated useful lives once commercial production or use of the product occurs. Equipment acquired to conduct research and development activities are capitalized and amortized over their estimated useful lives.

(f) Intangibles

Intangibles, consisting of non-competition agreements, are recorded at cost and amortized on a straight-line basis over their two year term.

(g) Goodwill

Goodwill is the residual amount that results when the purchase price of a acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on the fair values.

Goodwill is not amortized and is tested for impairment at the end of each year, or more frequently if events or changes in circumstances indicated that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting segment is compared to its fair value. When the fair value of the reporting segment exceeds its carrying amount, goodwill of the reporting segment is considered not to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of the reporting segment's goodwill exceeds its fair value, in which case the implied fair value of the reporting segment's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The Fund has conducted its annual goodwill assessment and determined that there was no impairment for 2005.

(h) Long-lived assets

Management assesses the carrying value of long-lived assets on a periodic basis for indications of impairment. Indications of impairment include an ongoing lack of profitability and significant changes in technology. When an indication of impairment is present, a test for impairment is carried out by comparing the carrying value of the asset to its net recoverable amount. If the carrying amount is greater than the net recoverable amount, the asset would be written down to its estimated fair value. In 2005 there were no indications of impairment.

(i) Foreign currency translation

The Fund's United States ("US") subsidiary is accounted for as a self-sustaining operation. Accordingly, the subsidiary's accounts in foreign currencies and operations have been translated into Canadian dollars using the current rate method. Monetary and non-monetary items denominated in US dollars are translated to Canadian dollars at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average exchange rate for the month the transaction occurred. Gains or losses arising on translation are deferred and reported as a foreign currency adjustment as a separate component of unitholders' equity.

Transactions denominated in a currency other than Canadian dollars are translated by applying exchange rates in effect at the transaction date. At the end of the year, monetary assets and liabilities denominated in a foreign currency are translated using the exchange rate as at that date. Any resulting foreign exchange translation gains and losses are charged to earnings in the year.

(j) Per unit amounts

Basic per unit amounts are calculated using the weighted average number of fund units outstanding during the period. Diluted per unit amounts are calculated using the treasury stock method where deemed proceeds of the exercise of unit options are considered to be used to re-acquire fund units at an average unit price. The weighted average number of units outstanding is then adjusted by the net change.

(k) Income taxes

The Fund is a mutual fund trust for purposes of the Income Tax Act (Canada) and is only subject to income taxes on taxable income not distributed to the unitholders. The Company is subject to certain corporate income taxes, and follows the liability method of accounting for income taxes.

(l) Stock-based compensation plans

The Fund has a unit option plan which is described in note 10(c). Commencing in 2003, the fair value of unit options are expensed over the vesting period. For stock options issued prior to 2003, pro forma disclosure of the effect on net earnings and earnings per unit had the fair value been expensed is provided. The fair value of unit options that have been expensed is credited to contributed surplus.

(m) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the year. Actual results could differ from such estimates by a material amount.

(n) Comparative figures

Certain comparative figures have been reclassified to conform to the current year's financial statement presentation.

2. ACQUISITIONS:

(a) Division of Wellco Energy Services Partnership

On October 21, 2005, the Fund completed the acquisition of the assets and the business of a horizontal and directional drilling services division of the Wellco Energy Services Partnership. The division conducted its drilling business throughout western Canada.

The acquisition was accounted for using the purchase method. The details of which were as follows:

Consideration:	
Cash	$ 4,691,555
Allocated to:	
Drilling and other equipment	$ 4,691,555

In addition to the cash consideration paid, a holdback in the amount of $250,000 was placed in trust. This will be released to the vendor if certain operational criteria are met over a future period. If the criteria is achieved, the balance will be allocated to drilling and other equipment.

(b) Radius Directional Services Ltd.

On March 9, 2004, the Fund completed the acquisition of the assets and the business of a private horizontal and directional drilling services company, Radius Directional Services Ltd., and its wholly owned subsidiary Radius Directional Services Inc. ("Radius"). Radius offered its drilling services throughout western Canada.

The acquisition was accounted for using the purchase method. The details of which were as follows:

Consideration:	
Cash (including transaction costs of $70,768)	$ 5,503,803
Issue of 1.15 million shares	3,507,500
Assumption of debt	1,801,386Net
consideration	10,812,689
Allocated to:	
Drilling and other equipment	4,750,830
Intangibles	300,000
Goodwill	5,761,859
	$ 10,812,689

The total of 1.15 million common shares of the Fund were issued at an ascribed value of $3.05 per share. The ascribed per share value was based upon the closing price on the Fund's shares on the Toronto Stock Exchange.

3. DRILLING AND OTHER EQUIPMENT:

2005	Cost	Accumulated Depreciation	Net Book Value
Directional drilling equipment	$ 40,824,566	$ 13,759,782	$ 27,064,784
Rental equipment	3,012,183	974,595	2,037,588
Office and computer equipment	1,084,779	785,058	299,721
Machinery and equipment	632,293	423,221	209,072
Vehicles	310,923	114,106	196,817
	$ 45,864,744	$ 16,056,762	$ 29,807,982

2004	Cost	Accumulated Amortization	Net Book Value
Directional drilling equipment	$ 30,054,954	$ 10,464,204	$ 19,590,750
Rental equipment	2,545,911	599,336	1,946,575
Office and computer equipment	898,250	648,960	249,290
Machinery and equipment	525,714	356,365	169,349
Vehicles	292,839	84,932	207,907
	$ 34,317,668	$ 12,153,797	$ 22,163,871

During the year, the Fund recognized depreciation on drilling and other equipment in the amount of $4,826,549.

4. INTANGIBLES:

2005	Cost	Accumulated Amortization	Net Book Value
Non-competition agreements	**$ 300,000**	**$ 262,500**	**$ 37,500**

2004	Cost	Accumulated Amortization	Net Book Value
Non-competition agreements	$ 300,000	$ –	$ 300,000

During the year, the Fund amortized intangibles in the amount of $262,500.

5. RESEARCH AND DEVELOPMENT COSTS:

There were no development costs capitalized during the year (2004 – $89,440). Research costs charged to earnings during the year were $598,594 (2004 – $689,940) that included $nil (2004 – $171,561) in amortization of deferred development costs and were net of $37,119 (2004 – $145,439) in investment tax credits received.

6. DEMAND LOAN:

The Fund has access to a demand revolving loan facility of up to $5.0 million. The demand loan would bear interest at the bank's prime rate plus .375 percent and is secured by security discussed in Note 8.

7. DISTRIBUTION PAYABLE:

During the year, the Fund paid monthly distributions totaling $10,788,735 (2004 – $4,463,565). The Fund declared a distribution of $0.05 per unit or $1,106,028, payable on January 16, 2006. In aggregate, distributions of $11,070,767 (2004 – $5,287,559) were declared for the year.

8. LONG-TERM DEBT:

	2005	2004
Non-revolving bank loans, with monthly repayments of $125,000 plus interest. Interest, at the Fund's option is at bank prime rate plus .50 percent or at the bank's banker's acceptance rate plus a stamping fee of 1.25 percent, and is being repaid over a sixty-month period.	$ 3,275,000	$ 4,775,000
Less current portion	1,500,000	1,500,000
	$ 1,775,000	$ 3,275,000

Principal payments due are as follows:	
2006	$ 1,500,000
2007	1,400,000
2008	300,000
2009	75,000
	$ 3,275,000

In addition, the Fund has access to a revolving loan facility of up to $1,870,000 to be used to assist in the acquisition of drilling and other equipment. The loan would bear interest at the Fund's option at the bank's prime rate plus .50 percent or at the bank's banker's acceptance rate plus a stamping fee of 1.25 percent.

The demand facility, the non-revolving loan, and this revolving loan facility are secured by a general security over all the assets of the Fund and hereafter acquired by the Fund, assignment of related insurance coverage, and a fixed charge over each asset acquired by the Fund under the revolving loan facility.

9. INCOME TAXES:

(a) The provision for income taxes differs from the amounts that would be obtained by applying the expected combined federal and provincial statutory income tax rate of 34 percent as follows:

	2005	2004
Expected income tax expense	$ 5,488,473	$ 2,054,835
Add (deduct):		
Unitholders' distributions	(3,764,060)	(1,797,770)
Non-taxable portion of gains on disposal of assets	(55,745)	(415,849)
Non-deductible stock-based compensation expense	178,693	57,813
Other	232,639	(197,329)
	$ 2,080,000	$ (298,300)

(b) Future income taxes arise from temporary differences, which are differences between the tax basis of an asset or liability and its carrying amount on the balance sheet. The tax effects of temporary differences that give rise to significant portions of the future income tax assets and liabilities at December 31 are presented on the following page:

	2005	2004
Future income tax liabilities:		
Partnership income	$ 4,864,271	$ 2,533,960
Drilling and other equipment	2,902,236	2,170,641
Investment tax credits	484,360	441,330
	8,250,867	5,145,931
Future income tax assets:		
Unused income tax losses (expiration in 2011 and 2012)	(3,637,995)	(2,301,090)
Unit issue costs	(646,774)	(583,930)
Other (including foreign and other tax credits)	(2,140,687)	(21,711)
	(6,425,456)	(2,906,731)
Net future income tax liability	$ 1,825,411	$ 2,239,200

10. UNITHOLDERS' CAPITAL:

(a) Authorized and issued units

Pursuant to the terms of the Plan of Arrangement, on July 1, 2004, each PTSI common shareholder received one (1) trust unit of the Fund for each common share held. The Fund is authorized to issue an unlimited number of trust units.

Prior to the Plan of Arrangement, the Company was authorized to issue an unlimited number of common voting shares without nominal or par value.

2004	Number	Amount
Common shares of Phoenix Technology Services Inc.		
Balance as at December 31, 2003	16,908,649	$ 20,624,493
Shares issued pursuant to acquisition (note 2b)	1,150,000	3,507,500
Shares issued pursuant to stock option plan	574,956	643,357
Escrow shares cancelled	(43,750)	(55,563)
Shares cancelled under the Plan of Arrangement	(18,589,855)	(24,719,787)
Balance as at July 1, 2004	–	$ –
Fund units of Phoenix Technology Income Fund		
Units issued pursuant to the Plan of Arrangement	18,589,855	$ 24,719,787
Units issued pursuant to unit option plan	10,000	12,628
Units issued pursuant to private placement (note 10e)	2,000,000	7,654,000
Balance outstanding, December 31, 2004	20,599,855	$ 32,386,415
Units issued pursuant to unit option plan	320,709	613,499
Units issued pursuant to equity financing (note 10e)	1,200,000	10,378,009
Balance outstanding, December 31, 2005	**22,120,564**	**$ 43,377,923**

(b) Basic and diluted earnings per unit

2005	Income (numerator)	Units (denominator)	Per-Unit Amount
Basic earnings per unit:			
Income available to trust unitholders	**$ 14,062,568**	**20,955,118**	**$ 0.67**
Diluted earnings per unit:			
Dilutive effect of unit option conversions	**–**	**371,315**	
Income available to trust unitholders	**$ 14,062,568**	**21,326,433**	**$ 0.66**

2004	Income (numerator)	Units (denominator)	Per-Unit Amount
Basic earnings per unit:			
Income available to trust unitholders	$ 6,341,931	18,173,988	$ 0.35
Diluted earnings per unit:			
Dilutive effect of unit option conversions	–	249,483	
Income available to trust unitholders	$ 6,341,931	18,423,471	$ 0.34

The calculation of dilutive earnings per unit does not include anti-dilutive options. These are options that would not be exercised because their exercise price is higher than the average market value of the units for the year. Including those options would cause the diluted earnings per unit to be overstated. The number of excluded options was 1,378,000 in 2005 (2004 – nil).

(c) Unit options

During 2005, the Fund granted 1,390,500 unit options at average exercise prices between $8.70 to $9.25, with expiration dates between September 27, 2010 to November 8, 2010. In addition a total of 320,709 options were exercised at an exercise price ranging from $0.80 to $4.25, and 38,252 options were cancelled. As at December 31, 2005, the Fund had a total of 1,729,366 options that remain outstanding which expire over a period of 2 to 5 years. Prior to the Plan or Arrangement on July 1, 2004, all Optionholders of PTSI exercised their vested options to acquire PTSI shares. During 2004, a total of 455,609 unvested options held by Optionholders to acquire PTSI shares were automatically exchanged for options to acquire units of the Fund on substantially the same terms and conditions.

A summary of the status of the plan as at December 31, 2005, is presented below:

	2005		2004	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, beginning of year	**697,827**	**$ 1.94**	1,093,169	$ 1.09
Granted	**1,390,500**	**8.98**	319,450	3.73
Exercised	**(320,709)**	**2.52**	(584,928)	1.43
Cancelled	**(38,252)**	**3.00**	(129,864)	2.06
Outstanding, end of year	**1,729,366**	**$ 3.43**	697,827	$ 1.94
Options exercisable, end of year	**97,691**	**$ 2.41**	13,332	$ 1.69

The range of exercise prices for options outstanding at December 31, 2005 are as follows:

	Options Outstanding			Options Exercisable	
Exercise Price	Number	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
$ 0.80	25,002	2.0 yrs	$ 0.80	25,002	$ 0.80
0.85	13,334	2.1 yrs	0.85	13,334	0.85
1.08	1,666	2.6 yrs	1.08	–	–
1.55	1,666	2.7 yrs	1.55	–	–
1.56	834	2.8 yrs	1.56	–	–
2.05	65,317	3.0 yrs	2.05	10,169	2.05
3.22	1,667	3.3 yrs	3.22	–	–
4.10	6,700	3.7 yrs	4.10	34	4.10
4.25	225,180	3.9 yrs	4.25	49,152	4.25
8.70	5,000	4.7 yrs	8.70	–	–
9.25	5,000	4.8 yrs	9.25	–	–
8.71	1,378,000	4.9 yrs	8.71	–	–
	1,729,366	3.2 yrs	$ 3.43	97,691	$ 2.41

On November 8 the fund issued 1,378,000 options under its unit option plan at the five day weighted average trading price of $8.71. These options vest over a 30-month period, and expire five years after the date of grant. The fair value of each option granted was $2.33. The fair value of options that were exercised for the year ended December 31, 2005 in the amount of $109,002 (2004 – $90,118) has been added to unitholders' capital.

The fair value of each option granted by the Fund was estimated on the date of grant using the Black-Scholes options pricing model with weighted-average assumptions for grants assuming distributions are paid on units, a risk-free interest rate range of 3.5 percent – 5.0 percent, an average life of 3.0 years, and an expected volatility of 50 percent. The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders. In 2005, the Fund recognized a total compensation expense of $525,567 (2004 – $170,039) for unit options granted in 2005.

Effective January 1, 2003, the Fund began prospectively expensing the fair value of unit options granted over the vesting period. In accordance with the prospective method of adoption, the Fund will continue to record no compensation expense for unit options granted prior to January 1, 2003, and will continue to provide pro forma disclosure of the net effect on net earnings and earnings per share had fair value been expensed.

If the fair value method had been used for options issued in 2002, an additional compensation expense of $87,000 (2004 – $87,000) would have been recognized, and the Fund's net earnings and earnings per unit would approximate the following pro forma amounts:

	2005	2004
Net earnings:		
As reported	$ 14,062,568	$ 6,341,931
Pro forma	13,975,568	6,254,931
Earnings per unit:		
Basic as reported	$ 0.67	$ 0.35
Diluted as reported	0.66	0.34
Basic pro forma	$ 0.67	$ 0.34
Diluted pro forma	0.66	0.34

(d) Dissenting shareholders

On April 15, 2004, the Fund reached a final settlement with a group of predecessor Company shareholders who exercised their right of dissent under a 2002 Plan of Arrangement, and a final payment of $1,068,668, including associated costs, were made. These payments were in excess of the par value of the related shares, and as a result, $1,068,668 was adjusted to retained earnings.

(e) Equity financing

In 2005, the Fund issued 1,200,000 units pursuant to a short form prospectus for net proceeds of $10,378,009, including share issue costs of $421,991. The share issue costs are net of a future income tax benefit of $270,000.

In 2004, the Fund issued 2,000,000 units pursuant to a private placement for net proceeds of $7,654,000, including share issue costs of $346,000. The share issue costs are net of the future income tax benefit of $179,000.

11. CONTRIBUTED SURPLUS:

	2005	2004
Balance outstanding, beginning of year	$ 654,900	$ 519,416
Stock based compensation expense	525,567	170,039
Fair value of options exercised	(109,002)	(90,118)
Cancellation of escrow shares	–	55,563
Balance outstanding, end of year	$ 1,071,465	$ 654,900

12. REORGANIZATION COSTS:

In 2004, the Fund incurred $657,616 in reorganization costs pursuant to the Plan of Arrangement in 2004. These costs are comprised of financial advisors, tax advisors, legal and other associated costs, which have been charged to the consolidated statement of earnings for the year ended December 31, 2004.

13. NOTE RECEIVABLE:

A provision of $1,202,000 was made in 2004 towards the full amount of a note receivable that related to the sale of drilling and other equipment in 2002. Its collection was tied to a certain level of performance of the assets by the purchaser, which was not achieved.

14. STATEMENT OF CASH FLOWS:

The changes in non-cash operating working capital items is comprised of the following:

	2005	2004
Decrease (increase) in current assets:		
Accounts receivable	$ (12,704,740)	$ (2,900,135)
Inventory	142,622	(256,378)
Prepaid expenses	(40,685)	(169,830)
Investment tax credit	–	(628,471)
Note receivable	–	1,944,750
Increase (decrease) in current liabilities:		
Accounts payable and accrued liabilities	3,051,608	(555,098)
Income taxes payable	(287,987)	(263,925)
Foreign exchange	(43,109)	(112,615)
Change in non-cash working capital	$ (9,882,291)	$ (2,941,702)

15. SEGMENTED INFORMATION:

The Fund provides directional and horizontal oil and gas well drilling services. The Fund's operating segments have been aligned geographically as follows:

2005	Canada	United States	Total
Revenue	44,372,225	25,110,390	69,482,615
Drilling and other equipment	25,010,602	4,797,380	29,807,982
Goodwill	8,876,351	–	8,876,351

2004	Canada	United States	Total
Revenue	30,491,668	13,354,781	43,846,449
Drilling and other equipment	19,082,322	3,081,549	22,163,871
Goodwill	8,876,351	–	8,876,351

16. COMMITMENTS:

The Fund is committed to the following minimum payments under operating leases for equipment and premises:

2006	$	827,854
2007		605,871
2008		504,708
2009		437,460
2010		437,460

During the year, the Fund paid $704,793 (2004 – $827,525) for various operating leases.

17. RELATED PARTY TRANSACTIONS:

During the year the Fund was charged $200,278 (2004 – $623,977) for the provision of various legal services from a director's firm of which he is a partner.

During the year the Fund received $nil (2004 – $59,932) for various services performed and $nil (2004 – $10,600) for the sale of various capital equipment from companies controlled by an officer and major unitholder of the Fund.

These transactions were completed in the normal course of operations on normal market terms and are measured at the exchange amounts.

18. FINANCIAL INSTRUMENTS:

(a) Credit risk

The Fund is exposed to normal credit risks of its customers that exist within the oil and gas exploration and development industry.

(b) Fair values of financial instruments

The carrying values of accounts receivable, accounts payable and accrued liabilities, distributions payable, and income taxes payable approximate their fair value due to the relatively short periods to maturity of the instruments. The fair value of long-term debt included in the consolidated balance sheet approximates fair values as the indebtedness is subject to floating rates of interest.

(c) Interest rate risk

The Fund manages its exposure to interest rate risk through floating rate borrowings.

(d) Foreign exchange risk

Due to operations of the Fund's subsidiary in the US, the Fund has an exposure to foreign currency exchange rates. Both the carrying values and earnings are subject to foreign exchange risk. Currently, there is no management program in place to mitigate this foreign exchange risk.

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Corporate Information

STOCK EXCHANGE LISTING

Trust Units of Phoenix Technology Income Fund are listed on the TSX under the trading symbol "PHX.UN".

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